Supreme Court, U.S.
FILED

98 781 NOV 13 1998

OFFICE OF THE CLERK

No.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1998

FLORENCE L. PETERS,
Petitioner,

v.

UNITED STATES OF AMERICA,
Defendant.

Petition for a Writ of Certiorari to the
United States Court of Appeals for the Seventh Circuit

PETITION FOR WRIT OF CERTIORARI

David V. Capes *
Sanford J. Boxerman
Rosenblum, Goldenhersh, Silverstein
and Zafft, P.C.
7733 Forsyth Blvd., Suite 400
St. Louis, MO 63105
(314) 726-6868

* *Counsel of Record*

St. Louis Law Printing, Inc. 14239 Manchester Rd. Manchester, MO 63011 314-231-4477

96pp

QUESTIONS PRESENTED

1. Whether the Taxpayer Bill of Rights and *United States v. Caceres* require suppression of evidence gathered by an IRS revenue agent from a taxpayer in a civil audit where possible criminal use of the information and the true nature of the investigation were not explained to the taxpayer?

2. Whether the "Firm Indications of Fraud Rule" should provide the standard to determine whether a consensual search is unreasonable under the Fourth Amendment or violative of due process under the Fifth Amendment because of alleged affirmative misrepresentations on the part of the IRS pursuant to the Taxpayer Bill of Rights?

PARTIES TO THE PROCEEDING

The parties to this proceeding in the Court of Appeals were Florence L. Peters and the United States of America.

TABLE OF CONTENTS

QUESTIONS PRESENTED i

PARTIES TO THE PROCEEDING ii

TABLE OF AUTHORITIES v

OPINIONS BELOW 1

JURISDICTION 1

CONSTITUTIONAL PROVISIONS AND STATUTE INVOLVED 2

STATEMENT 2

REASONS FOR GRANTING THE WRIT 9

1. The Taxpayer Bill of Rights 11
2. The "Firm Indications of Fraud" Rule 13

CONCLUSION 16

APPENDIX

A. Opinion of Seventh Circuit Court of Appeals A-1

B. Memorandum Opinion and Order Regarding Motion to Suppress entered on October 21, 1996 (Docket 96) A-40

C. Judgement Order of Seventh Circuit Court of Appeals A-61

D. Fourth and Fifth Amendments to U.S. Constitution A-62

E. Taxpayer Bill of Rights 26 U.S.C. 7521 et seq. ... A-63

F. Exhibit 25A from Hearing on Motion to Suppress Publication 1: Your Rights as a Taxpayer (Markings were on exhibit as submitted to the District Court) A-67

G. Two pages from Group Exhibit 1/Govt. Ex. Thompson 1A From Hearing on Motion to Suppress A-71

H. One page from Group Exhibit 1/Govt. Ex. Thompson 1A From Hearing on Motion to Suppress A-73

TABLE OF AUTHORITIES

CASES

Beckwith v. United States, 425 U.S. 341 (1976) 8,9,15

Gouled v. United States, 255 U.S. 298, 305-306 (1921) 6,11

Hoffa v. United States, 385 U.S. 293, 310 (1966) 8,9,15

Ohio v. Robinette, 117 S.Ct. 417 (1966) 8,9

Rogers v. Richmond, 365 U.S. 534 (1961) 8

Schneckloth v. Bustamonte, 412 U.S. 218 (1973) 8,9

United States v. Caceres 440 U.S. 741 (1979) 6,7,8, 9,10,15

United States v. LaSalle National Bank, 437 U.S. 298 (1998) 3,13,14

United States v. Lehman, 468 F.2d 93 (7th Cir.1972), cert. denied, 409 U.S. 967 (1972) 11

United States v. Stuart, 489 U.S. 353 (1989) 14

United States v. Tweel, 550 F.2d 297 (5th Cir. 1977).. 6,11

Wadena v. United States, 152 F.3d 831 (8th Cir. 1998) 7

CONSTITUTIONAL PROVISIONS AND STATUTES

Fourth Amendment 5

Fifth Amendment 5

26 U.S.C. 7521 et seq. 1,10

28 U.S.C. 1254 (1) 1

I.R.C. Sec. 7212 (a) 5

I.R.C. Sec. 7602 10

I.R.C. Sec. 7521 (d) 10

Pub. L. No. 100-647 1,2

MISCELLANEOUS

134 Cong. Rec. H9980 (daily ed. Oct.12, 1988) 11,12

134 Cong. Rec. S4134 (daily ed. April 15, 1988) 12

134 Cong. Rec. S15,073 (Oct.7. 1988) 12

134 Cong. Rec. S15,074 (daily ed. Oct.7, 1988) 11

Internal Revenue Manual, Sec. 9311.83(1) 11

Internal Revenue Manual, Sec. 4565.21(1) 13

Internal Revenue Manual, Sec. 4565.2 14

IRS Publication 1 ("Your Rights as a Taxpayer") 4,5,8

IRS Notice 609 ("The Privacy Act Notice") 4

Creighton R. Meland, Jr. Note, Omnibus Taxpayers' Bill of Rights Act, Taxpayers' Remedy or Political Placebo? 86 Mich.L.Rev. 1787,1795 (1988) 12

David Pryor, The Near-Totalitarian I.R.S., N.Y.Times, April 15, 1988 11

Michael I. Saltzman, IRS Practice and Procedure, Secs. 12.01 & 12.03[1][a] 13

Jerome Cramer, Putting a Leash on the IRS, Time, April 11, 1988 11

U.S. DEP'T OF TREASURY, Internal Revenue service Data Book, Pub. No. 55B, 3,16, tbls.2,13 (1995). 12

No.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1998

FLORENCE L. PETERS,
Petitioner,

v.

UNITED STATES OF AMERICA,
Defendant.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI

Florence L. Peters petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Seventh Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals is reported at 153 F.3d 445 and in full at Pet.App.A. The district court opinion is reported at 944 F.Supp. 646 and in full at Pet.App B.

JURISDICTION

The court of appeals entered its judgment on August 17, 1998.

See Pet. App. C. Petitioner invokes the jurisdiction of this court under 28 U.S.C. 1254 (1).

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

The provisions of the Fourth Amendment and the Fifth Amendment to the U.S. Constitution appear at Pet. App. D.

The Omnibus Taxpayer Bill of Rights, Pub. L. No. 100-647, codified in 26 U.S.C. 7521 *et seq.* appears at Pet.App.E.

STATEMENT

In 1988, Congress, concerned with IRS abuses and wishing to guarantee basic due process rights, enacted the Omnibus Taxpayer Bill of Rights. This statute required the IRS to prepare a statement which set forth in simple and nontechnical terms the rights of every taxpayer and the obligations of the IRS during an audit and taxpayer interview.[1] The statute further required the statement to be distributed to all taxpayers the Secretary contacted with respect to the determination or collection of any tax.[2] The statutory directive specifically prohibited distribution of the statement to taxpayers with respect to whom the IRS is conducting a criminal investigation.[3]

That same year, the IRS commenced a criminal tax investigation of Petitioner when a Special Agent took a confidential source "information item" from Petitioner's ex-husband and met with him about Petitioner's alleged illegal activities. The ex-husband, an attorney, provided the special agent with several hundred pages of documents from discovery provided him in a child custody dispute with Petitioner alleging that these docu-

---

[1] Pub. L. No. 100-647 at Sec. 6227(a).

[2] Id. at Section 6227(c).

[3] Id. at Section 6227(d).

ments established that Petitioner was using corporate funds to pay personal expenses. The special agent never opened a formal case in the Criminal Investigative Division as required to classify the matter. Instead, over the following eighteen months, he maintained the documents in the bottom drawer of his desk while he gathered additional information with the intent to investigate the case further as a criminal matter. There was never an official declination as required to terminate the criminal investigation.[4]

In January, 1990 the special agent wrote a letter and carried the file he had maintained across the hall at IRS to the Examination

---

[4] The testimony at the hearing on the Motion to Suppress established that Marshall Peters advised Special Agent Gerald Padar that his former wife, Petitioner, had engaged in illegal tax reporting practices and that Padar set up an appointment to meet personally with him (Motion Tr. 409-410); that Padar, Peters, and Peter's new wife met and Padar took an "information item" (Motion Tr. 415-416, 420-421); that Padar and Peters decided that Peters would provide Padar with photocopies of documents from the child custody dispute in which he and petitioner were engaged to substantiate his allegations against Petitioner (Motion Tr. 417-418); that although Padar did not consider Peters a "controlled informant", Peters would obtain additional records for Padar (Motion Tr. 420); that Peters provided Padar with more than 300 pages of documents including more than 400 checks showing false deductions (Motion Tr. 14, 418-419); that Padar assisted Peters and his wife in filing an IRS Form 211 which was retained with the file (Motion Tr. 423); that he had two or three personal meetings and several telephone calls from Peters and his wife (Motion Tr.427-428); that he conducted investigations on his own (Motion Tr. 445); that he never wrote a memorandum of any kind indicating that the Criminal Investigation Division was not interested in the matter, and his file contains no official declination of the matter as a criminal investigation (Motion Tr. 434). The testimony further established that Padar was "on the fence" as to whether to pursue the matter (Motion Tr. 458); that he never opened the case as a numbered case" and never closed it as a criminal investigation (Motion Tr. 450-451). The Special Agent's handbook requires that criminal matters be opened according to specific procedures and closed out and officially declined as criminal investigations. See *Unites States v. LaSalle National Bank*, 437 U.S. 298, 309, n. 12 (1978)

Division. There it became a "CID referral" and the Examination Division, armed with the evidence provided to the special agent, commenced an audit of Petitioner. [5]

At the beginning of the audit, the Petitioner was provided a copy of Publication 1, "Your Rights as a Taxpayer", the document prepared by the IRS in response to the Taxpayer Bill or Rights.[6] The IRS stated to her in the pamphlet that the IRS would explain and protect her rights, that the fact that her return was selected did not suggest that she was dishonest, and further that she had the right to know why the IRS was asking her for the information in the audit.[7]

Petitioner appointed her accountant to represent her in the audit. Petitioner's accountant inquired about the reason for the audit and the revenue agent informed him that "it was just a random audit." Thereafter, Petitioner cooperated, submitted to interviews and turned over records. The criminal nature of the audit, i.e. the prior investigation, the fact that Petitioner's husband was a confidential informant, contacts between him and the revenue agent, and the referral of Petitioner's documents by the special agent, were never revealed.[8] The representative would

---

[5] See Pet.App. G.

[6] See Pet.App. F.

[7] Petitioner was also sent IRS Notice 609 ("The Privacy Act Notice") at the initiation of the audit. As the court of appeals noted, "The IRS sends these forms to taxpayers at the inception of routine, ordinary audits, but does not mail them to the targets of a criminal investigation." See Pet.App. A, page 26, note 19.

[8] See Pet.App. A, page 8, note 16 and citations therein relating to the court of appeals position that, contrary to the assurances of the Taxpayer Bill of Rights, there is no duty on the part of an IRS revenue agent to warn a taxpayer or representative that an audit can lead to criminal consequences or that it is prompted by an informant's tip. These decisions are in conflict with the Taxpayer Bill of Rights and the statements in Publication 1.

have discontinued the audit and advised Petitioner to retain legal counsel had he known this information.

In April, 1991, the revenue agent made a determination that a firm indication of fraud existed in the case; as required by the Internal Revenue Manual, Section 4565.21, she then suspended the audit and wrote a fraud referral report. The Petitioner was not notified of this development. The revenue agent then turned the case over to her supervisor with a fraud referral recommendation. The supervisor felt that more information was needed to develop the case before sending it back to the Criminal Investigation Division. He reassigned the audit to a new revenue agent. Thereafter, additional information was again sought from Petitioner without a true explanation of the status and background of the matter. Petitioner's representatives provided this information and continued to rely on the original representations about the civil nature of the case as contained in Publication 1. Specifically, they relied upon assurances that the audit was a "routine audit" which would be completed with a report noting any adjustments and additions to tax. Petitioner never received such a report or deficiency notice. In anticipation of resolving the case civilly, Petitioner also executed consents extending the statute of limitations on civil tax liability.

Subsequently, a second fraud referral report was written and the case was returned to the Criminal Investigation Division. Following a lengthy further criminal investigation, Petitioner and her corporation were indicted and charged with criminal violations of the Internal Revenue Code. The charges included an allegation that Petitioner violated 26 U.S.C. Section 7212(a), in that from 1987 through 1992, she corruptly endeavored to obstruct or impede the due administration of the internal revenue laws in connection with her alleged actions during the audit itself.

In response to a Motion to Suppress on Fourth and Fifth Amendment grounds, the district court acknowledged this Court's

decision in *Gouled v. United States*, 255 U.S. 298, 305-306 (1921), requiring suppression of evidence obtained by government agents through "stealth". The district court held that this rule bars the use of evidence obtained in a consensual IRS audit "if the consent was induced by deceit, trickery, or misrepresentation," relying on *United States v. Tweel*, 550 F.2d 297 (5th Cir. 1977). The district court determined the motion on the basis of whether there were "affirmative misrepresentations" by the revenue agent and held that there would be such misrepresentations if the revenue agent continued to audit after she developed a "firm indication of fraud" under guidelines set forth in the IRS manual.

Although the district court felt compelled to conclude that under the "firm indications" rule there were no affirmative misrepresentations, the district court expressed "grave reservations" about the use of the rule and IRS manual to determine whether a criminal investigation is in progress. The district court concluded that in its current usage, the rule is "a classic example of bureaucratic double-talk" that improperly shields the IRS fraud referral process from judicial scrutiny. The district court also concluded that the rule supports a bifurcated system of tax enforcement based upon the erroneous assumption that a civil audit is not really a criminal investigation. The district court stated that to the extent the rule hangs on a formalistic distinction between civil and criminal tax investigations, it invites the IRS to engage in "constructive dishonesty" with taxpayers.

The district court opinion did not address the question of whether the Taxpayer Bill of Rights and this Court's decision in *United States v. Caceres*, 440 U.S. 741 (1979) required suppression of the evidence.[9]

---

[9] In *United States v. Caceres*, 440 U.S. 741, 749 (1979), this Court held that "a court's duty to enforce an agency regulation is most evident when compliance with the rule is mandated by the Constitution or federal law." This

(Continued on next page).

Characterizing the analysis of the district court as "sound", the court of appeals also felt that the case, in large part, concerned the distinction between a civil tax audit and a criminal investigation. The court of appeals, however, reasoned that the "firm indications of fraud rule" was a "good benchmark" for determining whether the IRS had attempted to conduct a criminal investigation under the guise of a civil audit. The approach adopted was different, however, from the Eighth Circuit's standard in the recent case of *Wadena v. United States*, 152 F.3d 831 (8th Cir. 1998).

The court of appeals agreed that the firm indications rule is a difficult standard for federal courts to apply "because it is inherently vague and depends, in large part, on the good faith and professional judgment of the revenue agents conducting the investigation at issue." The court of appeals recognized that "[w]hen applying this standard, federal courts must navigate between two perils...judicial micromanagement of the inner functions of an administrative agency...and judicial abdication of their Article III duty to protect the constitutional rights of criminal defendants."

The court of appeals then announced a six-part "guide" for federal courts with respect to the use of the rule as a tool in determining whether revenue agents have made an affirmative misrepresentation to a defendant or a representative concerning the nature of their investigation. The "guide" is based upon the court of appeals' review of fourteen appellate and federal district court decisions which have considered the rule with differing approaches and results.[10]

(Footnote 9 Continued.)

Court also held that violation of an agency rule may implicate due process concerns where "an individual has reasonably relied on agency regulations promulgated for his guidance or benefit and has suffered substantially because of their violation by the agency." *Id.* at 752-753.

[10] See Pet.App. A, pages A-16-23, and cases discussed therein.

The court of appeals relegated discussion of the Taxpayer Bill of Rights to a footnote. It concluded that Publication 1 contained no affirmative misrepresentations concerning the IRS's understanding of the case at the time it was mailed. The court, therefore, declined to decide whether the Taxpayer Bill of Rights of 1988 provided a viable ground for the suppression of evidence in a criminal tax proceeding. [11]

In a concurring opinion, Judge Easterbrook, also ignoring any effect of the Taxpayers Bill of Rights, took issue with the panel's "guide" and any limitations on continued use of the "Firm Indications of Fraud Rule." Relying upon *Hoffa v. United States*, 385 U.S. 293, 310 (1966), he concluded that law enforcement officers (apparently including revenue agents) are under no duty to call a halt to a criminal investigation the moment they have the minimum evidence to establish probable cause; and relying upon *United States v. Caceres* 440 U.S. 741 (1979), he held that a violation of the "Firm Indication Rule" does not justify use of the exclusionary rule. Under his analysis, *Beckwith v. United States*, 425 U.S. 341 (1976) was dispositive of this case because it held that so far as the Constitution is concerned, revenue agents may interrogate and gather evidence from taxpayers whom the IRS believes have engaged in criminal wrongdoing.

Judge Easterbrook also took issue with the conclusion that a taxpayer's consent, following an agent's misstatement about the weight of existing evidence, is ever involuntary. Relying upon *Ohio v. Robinette*, 117 S.Ct. 417 (1966), *Schneckloth v. Bustamonte*, 412 U.S. 218 (1973), and *Rogers v. Richmond*, 365 U.S. 534 (1961), he opined that the Supreme Court had adopted the voluntariness test of coerced confession cases which has not been deemed to compel the exclusion of statements obtained by police misrepresentation of the crime under investigation. Therefore, he reasoned that in a tax audit situation, such as in this case, the misunderstanding of one's status

---

[11] See Pet.App. A, page A-26, note 19

as a target abetted by calculated silence and half-truths from agents does not render a disclosure of physical evidence or testimony involuntary. Judge Easterbrook stated that "deception plays an important and legitimate role in law enforcement"; and that "even chicanery that creates the crime being prosecuted is Constitutionally permissible."

Recognizing that there is "tension between those lines of cases," Judge Easterbrook predicted "one of these days the Supreme Court will confront the tension." Until then, Judge Easterbrook concluded, the majority approach involving analysis under the "Firm Indications Rule" was "a snipe hunt for reasons developed in *Hoffa* and reiterated in *Beckwith*"; and that judicial scrutiny of voluntariness was subject to deferential appellate review under *Robinette* and *Schneckloth*.

REASONS FOR GRANTING THE WRIT

The court of appeals' decision and concurring opinion erroneously reach a result that is contrary to express provisions in the Taxpayer Bill of Rights and this court's decision in *United States v. Caceres*.[12] This law requires the IRS not to utilize Publication 1 in a "criminal investigation". In this case, there was no dispute that there had been criminal investigation activity which had prompted the audit of Petitioner.

Petitioner argued below, and continues to press the position in this Court, that because the matter was a Criminal Investigation Division "referral", she was misled by receiving the assurances in Publication 1, and in being told the audit was "routine". The result was that promises and statements were made to her which were deceptive and misleading under the requirements of the Taxpayer Bill of Rights. Specifically, the statute states in mandatory terms that the dissemination of a document advising a taxpayer of his or her rights will not apply in "criminal

[12] See n. 9, supra.

investigations".[13] There is no delineation or bright line in the statute concerning when an audit constitutes a "criminal investigation".[14]

The court of appeals erroneously decided it unnecessary to deal with the Taxpayer Bill of Rights. The concurring opinion of Judge Easterbrook makes no mention of the statute; however, it appears to actually endorse the use of Publication 1 in situations such as this case in which a criminal investigation had occurred. Judge Easterbrook reads *United States v. Caceres* to hold that "the IRS's violation of its own rules or procedures for conducting investigations does not justify use of the exclusionary rule."[15] The concurring opinion thus sanctions deceit and misrepresentation for law enforcement purposes by the IRS in taxpayer examinations without regard to the Taxpayer Bill of Rights' mandate to provide honest information to a taxpayer.[16]

The Taxpayer Bill of Rights requirement of honesty on the part of the IRS is consistent with well-developed precedent

---

[13] See n.3, supra. This provision is now codified as I.R.C. Section 7521 (d) in Title 26, United States Code.

[14] The IRS is empowered by statute and case law to issue an administrative summons for testimony and documents. I.R.C. Section 7602 permits the IRS to require the production of books, records, and other data relevant to its inquiry and to take testimony under oath. However, I.R.C. Section 7602 (c) states that an administrative summons may not be issued nor may any summons enforcement action be commenced, "with respect to any person if a Justice Department referral is in effect with respect to such person." This statute thus provides a Congressionally-sanctioned "bright line" test enabling courts to decide questions which arise under its provisions.

[15] See Pet.App. A, page A-35.

[16] Id., page A-38 wherein Judge Easterbrook concludes, "...Much evidence is properly acquired by concealing a person's status as an agent of law enforcement...Deception plays an important and legitimate role in law enforcement...lack of candor about the purpose of an investigation is no more fatal to a consent search than it is to a confession."

going back to *Gouled v. United States*, 255 U.S. 298, 305-306 (1921), numerous decisions of lower courts, and the IRS's own internal procedures, all of which preclude the use of government stealth and misrepresentation in taxpayer audits.[17] Because it fails to consider the statute's commands and proper application in this case, the court of appeals decision is fundamentally wrong as a matter of law, and this warrants review by this Court.

1. The Taxpayer Bill of Rights

This case involves national policy considerations under the Taxpayer Bill of Rights that must be addressed if statutory safeguards and basic due process rights are to be guaranteed. The Taxpayer Bill of Rights was intended to make a "major and substantial change in the fundamental relationship between the taxpayer and the tax collector."[18] It was intended by Congress to "level the playing field" between taxpayers and the IRS.[19] The Congressional Record makes numerous references to securing taxpayers' "basic due process rights" in their dealings with the IRS and to providing individuals with greater protection against "[t]he oppressive power and awesome resources of the federal

---

[17] See *United States v. Tweel*, 550 F.2d 297,299 (5th Cir. 1977) and Internal Revenue Manual Sec. 9311.83(1) (stating that "under no circumstances" should the Service "develop a criminal tax case under the guise of a civil audit"); additional cases warning that revenue agents must not affirmatively mislead a taxpayer into believing that the investigation is exclusively civil in nature are collected in *United States v. Lehman*, 468 F.2d 93 (7th Cir.1972), cert. denied, 409 U.S. 967 (1972).

[18] 134 Cong. Rec. H9980 (daily ed. Oct.12, 1988) (statement of Rep. Tallon); *See* Jerome Cramer, Putting a Leash on the IRS, Time, April 11, 1988, at 49 (describing the motives for the legislation); David Pryor, The Near-Totalitarian I.R.S., N.Y.Times, April 15, 1988, at 35 (same).

[19] 134 Cong.Rec. S15,074 (daily ed. Oct.7, 1988) (statement of Sen. Pryor).

government in order to restore and maintain basic due process rights on the part of taxpayers."[20]

Recent statistics reflect that more than 200,000,000 tax returns are filed on an every year.[21] Of these, more than 2,000,000 returns are examined.[22] Since 1988, Congress has mandated the distribution of IRS Publication 1, "Your Rights As A Taxpayer," in every examination. This pamphlet makes promises to the taxpayer on behalf of the government about the audit process. These promises include the taxpayer's right to know why the audit has occurred, what might be done with the information, what might happen if the taxpayer doesn't provide the information, and that the taxpayer has a right to have his rights protected by the IRS at all times. Congress decreed by statute that those promises not be made to any taxpayer in "criminal investigations".

The opinion does not address the question of whether the Taxpayer Bill of Rights, enacted to insure that taxpayers receive honest and truthful information from the IRS, provides a viable and separate ground for the suppression of evidence in a criminal

---

[20] See, e.g., 134 Cong. Rec. H9980 (daily ed. Oct.12, 1988) (statement of Rep. Tallon)(asserting that taxpayers' basic due process rights must be honored); 134 Cong.Rec. S15,073 (Oct.7. 1988) (statement of Sen. Pryor) (stating that "basic safeguards" must be restored); 134 Cong. Rec. S4134 (daily ed. April 15, 1988) (statement of Sen. Pryor) (stating that taxpayers' "basic due process rights" must be maintained); See also Creighton R. Meland, Jr. Note, Omnibus Taxpayers' Bill of Rights Act, Taxpayers' Remedy or Political Placebo? 86 Mich.L.Rev. 1787,1795 (1988) (noting that Taxpayer Bill of Rights was prompted by "horror stories", and that the bill's provisions were intended to address "IRS overreaching").

[21] For the fiscal year 1995 (Oct.1,1994 through September 30, 1995) for example, a total of 205,747,000 tax returns were filed. In the same time period, 2,100,144 were examined. See U.S. DEP'T OF TREASURY, Internal Revenue service Data Book, Pub. No. 55B, 3,16, tbls.2,13 (1995).

[22] *Id.*

tax proceeding where a taxpayer has not received honest information from the IRS about the true nature of the investigation. Certiorari should be granted to guide the lower federal courts in applying the statute correctly.

2.The Firm Indications of Fraud Rule

The court of appeals decision endorses (and also provides a six-part "guide" for) the continuing use of the Internal Revenue Manual's "Firm indications of Fraud Rule".[23] The opinion requires trial courts to use this rule as the sole determinant of whether affirmative misrepresentations have been made in an audit about the true nature of the investigation.[24] The opinion does not address the question of how this approach interfaces with the Taxpayer Bill of Rights, enacted to insure that taxpayers in any audit situation (including interviews) receive honest and truthful information from the IRS.

In *United States v. LaSalle National Bank*, 437 U.S. 298, 305 (1978), this Court granted certiorari because of the importance of the issue of use of summonses in the enforcement of the Internal Revenue Laws, and because of a conflict among the courts of appeals concerning the scope of summons authority. The Court held that whether an investigation has solely criminal

---

[23] Under IRS regulations, a revenue agent who uncovers a "firm indication of fraud on the part of the taxpayer" must immediately suspend her audit and refer the case to the Criminal Investigative Division. At that point, the CID enters the case and the IRS's efforts become focused on the possibility of criminal prosecution. See Internal Revenue Manual, Sec. 4565.21(1); *see generally* Michael I. Saltzman, IRS Practice and Procedure, Secs. 12.01 & 12.03[1][a].

[24] The district court had held that it would "find that the revenue agents were engaged in a covert criminal investigation if they continued to audit Petitioner after they developed a firm indication of fraud." The court of appeals believed "the district court's approach to this issue [was] a sound one." See. Pet.App.A, page A-12.

purposes must be answered by an examination of the institutional posture of the IRS. Id. at 316. In *United States v. Stuart*, 489 U.S. 353, 363 (1989), the Court, in referring to its earlier decision in *LaSalle National Bank*, affirmed that it had a "concern about permitting the IRS to encroach upon the rights of potential criminal defendants."

Certiorari should be granted in this case based upon the same "concerns" expressed by the Court in those prior decisions. There is a need to clarify the meaning of the term "criminal investigation" in the Taxpayer Bill of Rights and to decide when an audit is a disguised "criminal investigation" that infringes the statutes purposes and guarantees. As the district court properly recognized:

> ...the "firm indication" rule supports a bifurcated system of tax enforcement which is based upon the assumption that a civil audit is not really a criminal investigation. This assumption is simply erroneous. Although the vast majority of civil audits do not lead to criminal prosecutions, some do. To argue that the subject of a civil audit should be denied the same constitutional protections afforded to the subject of a CID investigation is analogous to arguing that the subject of a police stop should be denied constitutional protections because most such stops do not lead to criminal prosecution. If the evidence gathered in a civil audit may be used as part of a criminal prosection, then the civil audit is part of a criminal investigation. The "firm indications rule" is at best a permeable and at worst an invisible barrier between the civil and criminal investigation functions of the IRS.

The district court felt that rule invited the IRS to engage in "constructive dishonesty" with the taxpayer, but decided that precedent required following the rule. This was the sole basis upon which it concluded that Petitioner could not establish affirmative misrepresentations requiring suppression.

Unless this Court acts to reconsider the role of the "firm indications rule" and the Taxpayer Bill of Rights by granting the petition in this case, the basic due process rights of the millions of unsuspecting taxpayers who undergo audits will be undermined. These are the taxpayers referred to the IRS through information items, informant tips, and criminal referrals as was Petitioner. Under the decision of the court of appeals, contrary to Congressional intent, these taxpayers will, in effect, continue to be abused, misled and lied to by their government through the IRS about both their status and the potential consequences of their audits.

This Court's decisions in *Hoffa*, *Beckwith*, and *Caceres* all occurred before the Congress enacted the Taxpayer Bill of Rights into law. Contrary to the views expressed in the concurring opinion by Judge Easterbrook, these decisions should not be read after the enactment of this law to sanction the right of revenue agents as "law enforcement personnel" to utilize deception as a tactic in taxpayer examinations.

Certiorari should be granted to determine whether a lack of candor from a revenue agent about the reason for, and purpose of, an examination under the procedure embodied in the Internal Revenue Manual's "firm indications rule" should now be deemed fatal to a consent search. Where the revenue agent has not been truthful with the taxpayer about the true nature of the investigation as required by the Taxpayer Bill of Rights, this Court now presents the last hope for correction of the situation as a matter of law.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

DAVID V.CAPES*
SANFORD J. BOXERMAN
Rosenblum, Goldenhersh Silverstein,
and Zafft, P.C.
7733 Forsyth Blvd., Suite 400
St. Louis, MO 63105
(314) 726-6868

November 12, 1998

*Counsel of Record

APPENDIX

INDEX TO APPENDIX

Page

Appendix A
Opinion of Seventh Circuit Court of Appeals A-1

Appendix B
Memorandum Opinion and Order Regarding Motion to Suppress entered on October 21, 1996 (Docket 96) A-40

Appendix C
Judgement Order of Seventh Circuit Court of Appeals A-61

Appendix D
United States Constitution, Amendment IV A-62
United States Constitution, Amendment V A-62

Appendix E
Taxpayer Bill of Rights; 26 U.S.C. Section 7521 et seq. A-63

Appendix F
Exhibit 25A from Hearing on Motion to Suppress Publication 1: Your Rights as a Taxpayer (Markings were on exhibit as submitted to the District Court) A-67

Appendix G
Two pages from Group
Exhibit 1/Govt. Ex. Thompson 1A
From Hearing on Motion to Suppress A-71

Appendix H
One page from Group
Exhibit 1/Govt. Ex. Thompson 1A
From Hearing on Motion to Suppress A-73

APPENDIX A

IN THE
UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

No. 97-2634

UNITED STATES OF AMERICA,
Plaintiff-Appellee,

v.

FLORENCE L. PETERS,
Defendant-Appellant.

Appeal from the United States District Court
for the Northern District of Illinois, Eastern Division.
No. 95 CR 216 — George W. Lindberg, Judge.

Argued April 7, 1998 — Decided August 17, 1998

Before EASTERBROOK, RIPPLE and EVANS, Circuit Judges.

RIPPLE, *Circuit Judge*. After a jury trial, Florence L. Peters was convicted of four counts of making false statements on her tax returns in violation of 26 U.S.C. § 7206(1)[1] and one count of

---

[1] That section provides in pertinent part:

§ 7206. Fraud and false statements

Any person who—

(1) Declaration under penalties of perjury. — Willfully makes and subscribes any return, statement, or other document which contains or is verified by a written declaration that it is made under the penalties of perjury, and which he does not believe to be true and correct as to every material matter;

. . . .

(Footnote 1 continued on next page)

corruptly attempting to impede the administration of the internal revenue laws in violation of 26 U.S.C. § 7212(a).[2] On appeal, Dr. Peters contends that the district court erred in denying her motion to suppress evidence which, in her view, the IRS had obtained in violation of her Fourth and Fifth Amendment rights. In addition, Dr. Peters asserts that the evidence presented at trial was insufficient to support the jury's verdict. For the reasons discussed in the following opinion, we affirm the judgment of the district court.

(Footnote 1 continued)

shall be guilty of a felony and, upon conviction thereof, shall be fined not more than $100,000 ($500,000 in the case of a corporation), or imprisoned not more than 3 years, or both, together with the costs of prosecution.

[2] That section provides in pertinent part:

§ 7212. Attempts to interfere with administration of internal revenue laws

(a) Corrupt or forcible interference.—Whoever corruptly or by force or threats of force (including any threatening letter or communication) endeavors to intimidate or impede any officer or employee of the United States acting in an official capacity under this title, or in any other way corruptly or by force or threats of force (including any threatening letter or communication) obstructs or impedes, or endeavors to obstruct or impede, the due administration of this title, shall, upon conviction thereof, be fined not more than $5,000, or imprisoned not more than 3 years, or both, except that if the offense is committed only by threats of force, the person convicted thereof shall be fined not more than $3,000, or imprisoned not more than 1 year, or both. The term "threats of force", as used in this subsection, means threats of bodily harm to the officer or employee of the United States or to a member of his family.

I

BACKGROUND

A. The Contours of an IRS Investigation

The IRS splits the responsibility for enforcing the nation's tax laws between its two investigative divisions. The Criminal Investigative Division ("CID") is charged with investigating criminal violations of the tax code and related federal statutes. CID investigators are called "special agents." Like many other criminal law enforcement agents, they carry firearms and badges. In addition, special agents must recite an administrative warning prior to soliciting information from taxpayers. *See Beckwith v. United States*, 425 U.S. 341, 343 (1976) (quoting warning provided by special agents).

On the other hand, the Examination Division of the IRS is responsible for conducting civil tax audits. Examination Division investigators are known as "revenue agents." In contrast to special agents, revenue agents do not carry firearms; nor are they required to provide taxpayers with an administrative warning. Although an Examination Division audit typically concludes with some sort of civil settlement between the IRS and the taxpayer, such an audit may uncover evidence that causes the revenue agent to refer the case to the CID for criminal investigation. Under IRS regulations, a revenue agent who uncovers a "firm indication of fraud on the part of the taxpayer" must immediately suspend her audit and refer the case to the CID. *See Internal Revenue Manual* § 4565.21(1). At that point, the CID enters the case and the IRS' efforts become focused on the possibility of criminal prosection. *See generally* Michael I. Saltzman, *IRS Practice and Procedure* ¶¶ 12.01 & 12.03[1][a]. This case, in large part, concerns the distinction between a civil tax audit and a criminal tax investigation.

B. The Investigation

In October 1988, Marshall Peters, the former husband of podiatrist Dr. Florence Peters, called the Internal Revenue Service to report that he had information indicating that Dr. Peters had been cheating on her taxes. Marshall's call was received by Special Agent Gerald Padar of the CID. On October 6, Special Agent Padar went to Marshall's home; there he met with Marshall and his new wife, Eloise. At that meeting, Marshall showed Padar original corporate checks for Dr. Peters' corporation,[3] checks that Marshall had received in connection with a child support suit. A few weeks later, Marshall provided Padar with photocopies of corporate checks allegedly used by Dr. Peters to pay personal expenses. Marshall and Eloise Peters ultimately provided Padar with more than 300 pages of documents, including photocopies of more than 400 checks that Dr. Peters allegedly wrote for personal expenses but deducted as business expenses.

Special Agent Padar held this information for 18 months but did not open a formal criminal investigation. Instead, he maintained a file on Dr. Peters in the bottom drawer of his desk, where he collected the information supplied by Marshall and Eloise. On a few occasions, Padar reviewed the checks in that file. In addition, on one occasion, Padar drove by Dr. Peters' home to see what he could glean about her lifestyle and to attempt to corroborate information he had received from Marshall and Eloise concerning an addition to Dr. Peters' home. During that time, Padar received a few calls from Marshall and Eloise seeking information on the progress of the investigation.[4] Padar

---

[3] Dr. Peters practiced podiatry through a personal services corporation, Dr. Florence L. Peters, Ltd.

[4] On an earlier occasion, Marshall and Eloise filled out a claim form seeking a reward for the disclosure of original information about a criminal violation of the Internal Revenue Code. The record does not indicate whether they ever received a reward for their assistance in this case.

informed them that, under IRS nondisclosure regulations, he could not tell them anything. In January 1990, Special Agent Padar "walked" the information across the hall to the Examination Division. At that time, he prepared a two-page handwritten summary reflecting the informants' view of Dr. Peters' tax violations. He included that summary with the file. Padar did no further investigation.[5]

Padar's file on Dr. Peters ultimately landed on the desk of Thomas Ridgeway, a group manager in the Examination Division. Ridgeway assigned the case to Revenue Agent Margo Thompson, whom he described as a "rookie" in corporate audits. The Peters case was Thompson's first corporate audit that needed significant further development. When Ridgeway passed the file on to Thompson, he informed her that the case had begun because of an informant's tip received by the CID. He instructed Thompson to meet with the informants and to conduct an audit to determine if Dr. Peters had, in fact, deducted personal expenses as business expenses. Nonetheless, Thompson did not prepare a written audit plan because, in her view, the audit was routine. Thompson held this view because she had worked on other cases that were prompted by an informant's tip but were treated as routine civil audits and did not evolve into criminal investigations.

Revenue Agent Thompson began her audit by inputting the checks on the computer and calling up Dr. Peters' 1987 and 1988 returns. On July 2, 1990, Thompson initiated the first IRS contact with Dr. Peters. Thompson sent a standard form letter to Dr. Peters notifying her that her corporate returns for 1987 and 1988

---

[5] On one occasion after he had given the file to the Examination Division, Eloise contacted Padar and suggested that Dr. Peters would attempt to deduct expenses incurred in connection with her daughter's Bat Mitzvah as business expenses on her 1990 tax return. Padar forwarded this information to the Examination Division.

had been selected for an audit and requesting a meeting. Attached to the letter was the standard Information Document Request for a corporate audit, requesting numerous corporate and accountant records. Thompson also attached copies of two other documents which are routinely sent to the taxpayer when the IRS initiates a civil audit: (1) IRS Publication 1, a form called "Your Rights as a Taxpayer," and (2) IRS Notice 609, the "Privacy Act Notice." The purpose of IRS Publication 1 is to inform the taxpayer of her rights and some of the basic procedures and policies associated with a civil audit. The Privacy Act Notice informs the taxpayer of the IRS' legal right to ask for information, the reason the agency is asking for it ("to carry out the tax laws of the United States") and the consequences of failing to cooperate with the audit ("you may be charged penalties and, in certain cases, you may be subject to criminal prosecution"). The letter and attached forms contained no indication that the audit had been prompted by an informant's tip or that the case had been referred by the CID.

In response to this notice, Dr. Peters contacted the IRS and informed Thompson that her accountant, William Morrison, would represent her in the audit. Commencing shortly thereafter, Thompson conducted a series of personal meetings and telephone contacts with Morrison. During the course of these communications, Morrison asked Thompson whether she was conducting a "routine" or "ordinary" audit, and she replied in the affirmative. Although he did not remember Thompson specifically using the words "random" or "routine," he "absolutely" had the impression that it was a routine audit. Morrison came to this conclusion because of the normal manner in which Thompson was proceeding more than anything she said. Indeed, at the time of her initial meetings with Morrison, Thompson did not believe that any fraud was involved or that Dr. Peters had any criminal problems. She conducted the audit like any other. She did not inform Morrison that the investigation had been prompted

by an informant's tip or referred by the CID.[6] Nor did she provide a verbal warning that Dr. Peters might be subject to criminal penalties. Accordingly, Morrison continued to provide information on the belief that it was a routine audit.[7]

On November 5, 1990, Thompson first met with Dr. Peters. Prior to this meeting, Thompson had discovered an apparent discrepancy of approximately $100,000 in Dr. Peters' tax filings. However, she did not know yet whether this was a real discrepancy. This initial meeting lasted about two hours. Thompson conducted the meeting in the same manner as any other civil audit. She did not give Dr. Peters any indication or warning that there might be a possible criminal problem. She used the standard computer-generated interview form and asked the same general questions that she would ask in any audit. At the meeting, Thompson reiterated requests for information concerning Dr. Peters' corporation in order to verify the purpose of various corporate expenditures claimed by Dr. Peters. At this point, Thompson did not believe there was fraud but had concluded that there were expenses that needed to be explained.

However, by March 1991, Thompson began to suspect that the case might involve fraud. On March 28, after Thompson received Morrison's signed power of attorney, she informed him that she had discovered approximately $200,000 in unreported income and that she had questions regarding the legitimacy of some claimed business expenses. A few days later during another conversation, Morrison stated: "If [Dr. Peters] didn't report

---

[6] At this point, Thompson had not yet received a signed power of attorney authorizing Morrison to act on behalf of Dr. Peters' corporation. Accordingly, under IRS guidelines, she could receive information from Morrison but could not disclose any information to him concerning the investigation.

[7] At the suppression hearing, Morrison testified that he would have discontinued the audit and advised Dr. Peters to retain an attorney if Thompson had informed him of any of these facts at the initiation of the audit.

$200,000, it would be a case that would be a referral to CID." R.121-4 at 518. Thompson did not respond. By April 30, 1991, Thompson had concluded that the case involved fraud and began to prepare a criminal referral. However, whether the case bore the "firm indications of fraud" necessary for a criminal referral was ultimately her supervisor's decision.

By that time, Thompson had a new supervisor, Bruce Wilson. Wilson reviewed the case and concluded that there were not "firm indications of fraud." After reviewing Thompson's work, he determined that there were too many errors in Thompson"s analysis to substantiate a fraud referral. In particular, he believed that Thompson had disallowed all claimed expenses without analysis and had not given Dr. Peters adequate opportunity to prove the business deductions or to explain the apparent excess income. He concluded that there were "indicia of fraud" but decided that Dr. Peters should be given further opportunity to explain the discrepancies discovered by Thompson.

In July 1991, Wilson reassigned the Peters matter to Revenue Agents Cynthia Lensink and Steven Mittl. He instructed Lensink to reanalyze the business expense deductions and Mittl to recalculate Dr. Peters' income using a bank deposit analysis. On November 4, 1991, Lensink met with Morrison and Dr. Peters' newly-retained attorney, Ben Roth. During that meeting, Lensink asked Roth if his client would sign a consent form to extend the civil statute of limitations, thereby giving the IRS more time to settle the case or bring a civil action against Dr Peters. Roth responded that he would advise his client to sign the consent form. Lensink stated that she wished to bring the matter to a close quickly and that she had prepared a list of proposed adjustments for that purpose. Both Roth and Morrison assumed that Lensink was referring to a civil settlement. In addition, according to Roth, he asked Lensink at that meeting whether the case might be referred for criminal prosecution and she replied in the negative. Lensink, however, stated that Roth never asked her that question and that she never denied the possibility of a referral to the CID.

On December 17, 1991, Roth met with Lensink at Dr. Peters' home. The purpose of the visit was to observe Dr. Peters' claimed home office. At this meeting, Roth noticed a significant change in Lensink's attitude; she was no longer interested in reaching an agreement on the proposed adjustments. By this time, Lensink and Mittl had completed their analysis of both Dr. Peters' income and claimed business expenses. On December 19, 1991, the Revenue Agents completed a proposed criminal referral concerning Dr. Peters' 1988 and 1989 corporate and individual income tax returns. The proposed referral was submitted to Wilson. After reviewing the agents' work, Wilson concluded that the case was now sufficiently developed and that there were in fact "firm indications of fraud." Accordingly, he signed the referral. Morrison and Roth first learned of the referral in January of 1992.

After further review of the information compiled in the Examination Division audit, the CID recommended criminal prosecution of Dr. Peters. On April 11, 1995, a federal grand jury indicted Dr. Peters on four counts of criminal tax fraud. Counts I and III charged her with fraudulent conduct in violation of 26 U.S.C. § 7206(1) with regard to her corporate tax returns for 1988 and 1989. Those counts alleged that Dr. Peters had underreported her corporate income and had deducted personal expenses as business expenses on those returns. Counts II and IV charged her with making false statements on her personal returns for the same years in violation of § 7206(1). In addition, on November 14, 1995, the grand jury returned a superseding indictment. In that indictment, the grand jury added a fifth count. Count V charged Dr. Peters with obstructing the due administration of the Internal Revenue Code in violation of 26 U.S.C. § 7212(a).

C. Proceedings in the District Court

Prior to her trial, Dr. Peters moved to suppress the records and statements that she had offered to the IRS auditors between

April 1990 and January 1992. She asserted that the IRS obtained that evidence in violation of her Fourth and Fifth Amendment rights by telling her that they were conducting a routine civil audit when in fact they were carrying out a covert criminal investigation. After a six-day suppression hearing, the district court found that the civil revenue agents did not deliberately mislead Dr. Peters as to the nature of their investigation. Accordingly, the court denied Dr. Peters' motion to suppress. *See generally United States v. Peters*, 944 F. Supp. 646 (N.D. Ill. 1996).

After a lengthy trial in December 1996, a jury found Dr. Peters guilty on all five counts of the superseding indictment. Dr. Peters now asks this court to set aside her conviction on two grounds. First, she contends that the district court erred in denying her motion to suppress. In addition, she asserts that the evidence presented at trial was not sufficient to support the jury's verdict.

II

DISCUSSION

A.

Dr. Peters contends that the district court erred in denying her motion to suppress the records and statements that she had offered to the IRS auditors between April 1990 and January 1992. She asserts that the IRS obtained that evidence in violation of her Fourth and Fifth Amendment rights by conducting a criminal tax investigation under the guise of a civil audit. On review of a district court's ruling on a motion to suppress, this court reviews questions of law de novo and questions of fact for clear error. *See United States v. Sholola*, 124 F.3d 803, 811 (7th Cir. 1997). We shall conclude that a district court's factual finding is clearly erroneous only if we are left with the definite and firm conviction that a mistake has been made. *See United States v. Quinn*, 83 F.3d 917, 921 (7th Cir. 1996).

1.

A consensual search is unreasonable under the Fourth Amendment or violative of due process under the Fifth Amendment if the consent was induced by fraud, deceit, trickery or misrepresentation by the revenue agent.[8] *See United States v. Serlin*, 707 F.2d 953, 956 (7th Cir. 1983); *United States v. Lehman*, 468 F.2d 93, 104 (7th Cir.), *cert. denied*, 409 U.S. 967 (1972). In *Serlin*, we set forth the heavy burden that a defendant seeking suppression under this theory must meet:

> To prevail on this point defendant must produce clear and convincing evidence that the agents affirmatively mislead [sic] him as to the true nature of their investigation. Defendant must also prove that the misinformation was material in his decision to speak with the agents. Simple failure to inform defendant that he was the subject of the investigation, or that the investigation was criminal in nature, does not amount to affirmative deceit unless defendant inquired about the nature of the investigation and the agents' failure to respond was intended to mislead.

707 F.2d at 956 (internal citations omitted); *see also United States v. Stern*, 858 F.2d 1241, 1249 (7th Cir. 1988).

We turn, then, to the first part of the *Serlin* inquiry: Whether the civil revenue agents affirmatively misrepresented the nature of their investigation to Dr. Peters and her representatives. The district court found that the revenue agents, through their conduct and words, represented to Dr. Peters that they were conducting an ordinary or routine civil audit. Accordingly, if the agents were in fact conducting a criminal investigation under the

---

[8] Because all of the constitutional violations alleged by Dr. Peters depend on a showing of the existence of fraud, deceit and trickery, it is not necessary to discuss each constitutional claim separately. *See United States v. Prudden*, 424 F.2d 1021, 1032 (5th Cir.), *cert. denied*, 400 U.S. 831 (1970).

auspices of a civil audit, then they affirmatively misrepresented the nature of their investigation. *See United States v. Wadena*, Nos. 96-4141, 96-4145 & 96-4146, 1998 WL 300523, at *16 (8th Cir. June 10, 1998); *United States v. Grunewald*, 987 F.2d 531, 534 (8th Cir. 1993); *United States v. Nuth*, 605 F.2d 229, 234 (6th Cir. 1979); *United States v. Tweel*, 550 F.2d 297, 299 (5th Cir. 1977); *see also Internal Revenue Manual* § 9311.83(1) (stating that the IRS may not develop a criminal tax case under the guise of a civil audit). In addressing this issue, the district court noted that, under IRS guidelines, "a civil audit evolves into a criminal investigation at the point when the auditors develop a firm indication of fraud." *United States v. Peters*, 944 F. Supp. 646, 654 (N.D. Ill. 1996). Therefore, the court held that it would "find that the revenue agents were engaged in a covert criminal investigation if they continued to audit defendant after they developed a firm indication of fraud." *Id.*

We believe that the district court's approach to this issue is a sound one. Although this court has not yet addressed the precise issue presented in this case,[9] other courts that have addressed the

---

[9] In *United States v. Mapp*, 561 F.2d 685 (7th Cir. 1977), we addressed the "firm indications of fraud" standard in a slightly different context from the one we encounter here. In this case, Dr. Peters argues that the evidence obtained by the IRS during its civil audit should be suppressed because the IRS obtained that evidence by fraud, trickery, deceit and misrepresentation in violation of her Fourth and Fifth Amendment rights. By contrast, in *Mapp*, the taxpayer-defendant did not cast his argument in constitutional terms, but rather argued that the evidence obtained by the IRS during a civil audit should be suppressed because the revenue agents conducting the audit failed to refer the case to the CID after they developed "firm indications of fraud" in violation of the guidelines in the Internal Revenue Manual. In the first place, we held that the rules in the Internal Revenue Manual were adopted for the internal administration of the service and not for the protection of the taxpayer and therefore "conferred no rights on the taxpayer." *Id.* at 690 (citing *United States v. Lockyer*, 448 F.2d 417, 420-21 (10th Cir. 1971)). We went on to conclude that the IRS rules concerning criminal referral were not violated in that case.

(Footnote 9 continued on next page)

issue have relied on the "firm indications of fraud" rule as a good benchmark for determining whether the IRS has attempted to conduct a criminal investigation under the guise of a civil audit. *See, e.g., Wadena*, 1998 WL 300523, at *16 (requiring defendant seeking suppression of evidence to show that IRS continued with civil audit after it developed firm indications of fraud);[10] *Groder*

(Footnote 9 continued)

In *Serlin*, although we dealt with the issue of deception during the course of the IRS investigation, that case involved a taxpayer who was aware of the criminal nature of the investigation but did not realize that he was a potential target of that inquiry. Indeed, the *Serlin* court noted that its case differed from the "typical deceit case," which "involves a taxpayer who claims that his volubility was induced by assurances that the investigation was 'routine' and only civil rather than criminal." *See Serlin*, 707 F.2d at 957.

[10] We note that the approach we adopt today differs slightly in its articulation from the formula set forth by the Eighth Circuit in *Wadena* and *Grunewald*. In those cases, the Eighth Circuit set forth the following standard:

> Evidence obtained in the course of a criminal investigation, where the defendant has not been apprised of the nature of the investigation, may be suppressed only if the defendant establishes that: 1) the IRS had firm indications of fraud by the defendant, 2) there is clear and convincing evidence that the IRS intentionally misled the defendant, and 3) the IRS's conduct resulted in prejudice to defendant's constitutional rights. *Wadena*, 1998 WL 300523, at *16 (quoting *Grunewald*, 987 F.2d at 534). This articulation differs slightly from the formulation that we enunciated in *Serlin* in that the Eighth Circuit sets forth a "firm indications of fraud" test as an additional showing a defendant must make in order to succeed on a motion to suppress evidence obtained by the IRS during a civil audit. We agree with the Eighth Circuit, for the reasons discussed *infra*, that the "firm indications" rule is an important guide for courts that encounter a motion to suppress based on the allegation that the IRS has obtained evidence through fraud, trickery, deceit and misrepresentation. However, rather than articulating this factor as independent from a showing that the IRS affirmatively and intentionally misled the defendant, we believe that the "firm indications" rule is best utilized as a tool for assessing whether the IRS has

(Footnote 10 continued on next page)

v. United States, 816 F.2d 139, 142 (4th Cir. 1987) (holding that continuation of civil audit after the development of firm indications of fraud is relevant to issue of whether agency conducted investigation in good faith); *United States v. Piper*, 681 F. Supp. 833, 837 (M.D. Ga. 1988) (same). Indeed, when examining whether a revenue agent has misrepresented the true nature of her investigation, it is appropriate to consider the procedures and regulations under which she functions, including the "firm indications of fraud" rule:

> If, during an examination, an examiner discovers a firm indication of fraud on the part of the taxpayer, the tax return preparer, or both, the examiner shall suspend his/her activities at the earliest opportunity without disclosing to the taxpayer, the taxpayer's representative, or employees, the reason for such suspension.

Internal Revenue Manual § 4565.21(1). Therefore, if a revenue agent continues to conduct a civil audit after developing "firm indications of fraud," a court may justifiably conclude that the agent was in fact conducting a criminal investigation under the auspices of a civil audit.

Nonetheless, as the district court noted, the "firm indications of fraud" standard is a difficult standard for federal courts to

---

(Footnote 10 continued)

affirmatively misrepresented the nature of its investigation by conducting a criminal investigation under the guise of a civil audit. We do not believe that the Eighth Circuit's formulation is a doctrinal departure from the approach in *Serlin*. Indeed, in *Grunewald*, the Eighth Circuit stressed that the essence of its approach was the presence of affirmative and intentional misleading by the IRS. *See* 987 F.2d at 534 ("If IRS agents, exercising sound discretion and good judgment, fear suppression of evidence where no intentional, prejudicial misrepresentation is afoot, civil audits will prematurely and unnecessarily be referred to CID.").

apply because it is inherently vague and depends, in large part, on the good faith and professional judgment of the revenue agents conducting the investigation at issue. When applying this standard, federal courts must navigate between two perils. On the one side, courts face the Scylla of judicial micromanagement of the inner functionings of an administrative agency, a peril recognized by many of the courts that have addressed this issue.[11] Yet, on the other side, courts face the Charybdis of judicial abdication of their Article III duty to protect the constitutional rights of criminal defendants. As the district court recognized, this latter peril will be realized if the courts are forced to rely solely on the after-the-fact assessments of revenue agents who may have an incentive to use the discretionary nature of the "firm indications" rule to shield their actions from judicial scrutiny.

In navigating the narrow course necessitated by these two perils, courts must remember that the "firm indications of fraud" rule is but a tool for courts to utilize in determining whether the revenue agents made an *affirmative misrepresentation* to a defendant or her representatives concerning the nature of their investigation. Although we are mindful that the "firm indica-

---

[11] *See Grunewald*, 987 F.2d at 534 ("If IRS agents, exercising sound discretion and good judgment, fear suppression of evidence where no intentional, prejudicial misrepresentation is afoot, civil audits will prematurely and unnecessarily be referred to CID."); *United States v. Michaud*, 860 F.2d 495, 498-99 (1st Cir. 1988) (holding that courts must give considerable weight to the IRS' own interpretation of their regulations); *United States v. Caldwell*, 820 F.2d 1395, 1402 (5th Cir. 1987) (noting that referral decision was discretionary in nature and was not governed by any absolute criterion); *United States v. Groder*, 816 F.2d 139, 143-44 (4th Cir. 1987) (holding that second-guessing a revenue agent's judgment should not become a routine chore for judges because the administration of the revenue laws is a function which by congressional directive and by expertise belongs to the IRS, and warning that a less deferential approach "would encourage premature referrals of taxpayers for fraud investigations based on little more than a revenue agent's unsubstantiated hunch").

tions of fraud" rule cannot be expressed in a set of absolute criteria and that the facts and circumstances of each case must be assessed in their own light, we believe that the following discussion can serve as a guide to the courts who are called upon to navigate these narrow waters in the future. Our review of the relevant case law suggests several considerations that ought to be helpful to the district courts.

The IRS has been found to have engaged in impermissible deception if the Service has conducted a civil audit at the behest of a criminal law enforcement agency conducting an ongoing criminal investigation. This rule is based on the Fifth Circuit's holding in *United States v. Tweel*, 550 F.2d 297, 299 (5th Cir. 1977) and has been explicitly embraced by the IRS. *See Internal Revenue Manual* § 9311.83(1) (stating that "under no circumstances" should the Service "develop a criminal tax case under the guise of a civil audit"); *cf. United States v. Lehman*, 468 F.2d 93, 105 (7th Cir.) (stating that "the appellate court cases dealing with fraud in tax situations warn that revenue agents must not affirmatively mislead a taxpayer into believing that the investigation is exclusively civil in nature and will not lead to criminal consequences" (collecting cases)), *cert. denied*, 409 U.S. 967 (1972). In *Tweel*, the Examination Division began a civil audit of the taxpayer at the specific request of the Organized Crime and Racketeering Section of the Department of Justice. Thus, the audit was, in effect, conducted as part of an ongoing criminal investigation. In an attempt to ascertain the nature of the investigation, the taxpayer's representative asked the revenue agent if a special agent was involved in the investigation; the revenue agent answered in the negative. Although the revenue agent's answer was technically correct, the court found that he knew the purpose of the representative's question and that, therefore, his answer amounted to affirmative deceit. "[T]he agent's failure to apprise the appellant of the obvious criminal nature of this investigation was a sneaky deliberate deception by the agent . . . and a flagrant disregard for appellant's rights. The silent

misrepresentation was both intentionally misleading and material." *Tweel*, 550 F.2d at 299. The court further cautioned: "Our revenue system is based on the good faith of the taxpayers and the taxpayers should be able to expect the same from the government in its enforcement and collection activities."[12] *Id.* at 300.

Active involvement of CID personnel in a civil audit prior to the completion of a criminal referral also has been treated as compelling evidence that the IRS has proceeded beyond the point of "the firm indications of fraud" and attempted to use the audit as a covert criminal investigation. *See United States v. Caldwell*, 820 F.2d 1395, 1399 n.4 (5th Cir. 1987); *United States v. Robson*, 477 F.2d 13, 17 (9th Cir. 1973); *United States v. Smith*, 898 F. Supp. 464, 468 (W.D. Ky. 1995); *United States v. Piper*, 681 F. Supp. 833, 838 (M.D. Ga. 1988). This principle has its roots in the fact that the IRS, in an effort to comply with *Tweel*

---

[12] *See United States v. Groder*, 816 F.2d 139, 144 (4th Cir. 1987) ("[B]ad faith would arise if a revenue agent misrepresented to taxpayer the possibility of referral in order to elicit information for use in a fraud investigation. For the agent to obtain information in such a manner would destroy whatever reservoir of trust remains in citizen taxpayers and discourage the cooperation that might resolve matters in a prompt and satisfactory way."); *see also United States v. Piper*, 681 F. Supp. 833, 837 (M.D. Ga. 1988) ("'Inherent in our democracy is a belief that, since the government represents the will of the people, the people will accept its dictates voluntarily. There is a sense of trust between the government and the people. . . . [Therefore], a private person has the right to expect that the government, when acting in its own name, will behave honorably. When a government agent presents himself to a private individual, and seeks that individual's cooperation based on his status as a government agent, the individual should be able to rely on the agent's representations. [It is] clearly improper for a government agent to gain access to records which would otherwise be unavailable to him by invoking the private individual's trust in his government, only to betray that trust.'" (quoting *SEC v. ESM Government Sec., Inc.*, 645 F.2d 310, 316 (5th Cir. Unit B 1981))).

and its progeny, has constructed a "Chinese wall" between its civil examination and criminal investigation divisions.[13] Indeed, IRS guidelines specifically warn that revenue agents who are in the process of determining the appropriateness of a criminal referral must not "obtain evidence and/or direction from the Criminal Investigation Division for a specific case that is under examination."[14] *Internal Revenue Manual* § 4565.21(1). Conversely, a special agent who refers a case to the Examination Division as lacking in criminal potential must withdraw from the case under most circumstances. *See id.* at § 4565.7.

Continuation of audit activities after the revenue agent begins preparation of the fraud referral also may be indicative of an agency attempt to gather information for a criminal prosecution while keeping the taxpayer in the dark as to the true nature of its investigation. *See, e.g., United States v. Wadena*, Nos. 96-4141, 96-4145 & 96-4146, 1998 WL 300523, at *16 (8th Cir. June 10, 1998). Indeed, the Manual clearly directs a revenue agent to suspend her activities at the earliest opportunity after developing firm indications of fraud. *See Internal Revenue Manual* § 4350

---

[13] Under the IRS guidelines, a special agent may not participate in a civil audit. However, a revenue agent may participate in a joint investigation with the CID; once a joint investigation is undertaken, the criminal aspects of the investigation take precedence and the IRS must present the investigation to the taxpayer as such. *See Internal Revenue Manual* §§ 9311.83(1) & (31)610; *see generally* Michael I. Saltzman, *IRS Practice and Procedure* ¶ 12.01 (In recognition of the fact that attempts to pursue the criminal and civil aspects of a case concurrently can jeopardize successful prosecution of a criminal case, "the Service's policy is that criminal action in a case takes precedence over its civil aspects and that any civil enforcement action involving the same tax and periods as an active criminal investigation is suspended or deferred until the criminal aspects of the case are closed.").

[14] *Cf. Robson*, 477 F.2d at 17 (finding that revenue agent was not conducting covert criminal investigation because he had no instructions from CID, no interim conferences with CID personnel, and "was under no obligation to report to it unless his audit uncovered an indication of fraud").

HB 22(34); *see also* Michael I. Saltzman, *IRS Practice and Procedure* ¶ 12.03[1][a] ("The IRS instructs its personnel to be alert to indications of fraud and, when fraud is spotted, to suspend their civil activities and refer the case to CID."). Similarly, another Manual provision bars a revenue agent from "solicit[ing] an agreement or solicit[ing] and receiv[ing] delinquent returns prior to the submission of a fraud referral, if a referral is being considered." *Internal Revenue Manual* § 4565.21(1). Accordingly, if a revenue agent has determined that a case must be referred to the CID yet continues her regular audit activities in the interim, such behavior suggests an intent to gather evidence for a criminal prosecution under the aegis of a civil audit.

The case law suggests that a revenue agent has developed a firm indication of fraud when she has established that the taxpayer has engaged in a consistent pattern of substantial underreporting of income and/or overstatement of deductions such that an intent to evade taxes can be inferred. *See Internal Revenue Manual* § 4231 HB 940(1)(a)-(b), (f)1; *see also United States v. Grunewald*, 987 F.2d 531, 534 (8th Cir. 1993). Such a pattern is usually established only after the revenue agent has examined the taxpayer's returns filed over a period of several years. *See United States v. Lockyer*, 448 F.2d 417, 419-20 (10th Cir. 1971) (noting that evidence showed "a pattern of substantial understatements" for a three-year period and stating that referral is appropriate upon "discovery of a substantial understatement coupled with an indication that the understatement was deliberate"). Accordingly, once a revenue agent has discovered solid evidence that a taxpayer has engaged in a consistent pattern of this type of behavior, a court may infer that the revenue agent has developed "firm indications of fraud."

The case law recognizes that an assessment of the taxpayer's intent is the most critical element in a revenue agent's determination of whether "firm indications of fraud" exist in any

particular case. *See Caldwell*, 820 F.2d at 1492-93; *United States v. Groder*, 816 F.2d 139, 143-44 (4th Cir. 1987); *Piper*, 681 F. Supp. at 838. Indeed, it is the taxpayer's intent to evade taxes that differentiates a criminal violation from a civil case. For this reason, a revenue agent who discovers potential violations of the revenue laws will almost always give the taxpayer an opportunity to explain the violations before determining the appropriateness of a criminal referral. *See Internal Revenue Manual* § 4565.21(1); see generally *United States v. Kaatz*, 705 F.2d 1237, 1242 (10th Cir. 1983) (revenue agent interviewed taxpayers and their accountant on a number of occasions prior to referral). This step is viewed as a necessity because, given the complexity of the tax code, many innocent explanations exist for unreported income. *See Groder*, 816 F.2d at 143 ("[A] failure to report income correctly 'may be due to mistake, inadvertence, reliance on professional advice, honest difference of opinion, negligence or carelessness, none of which constitutes deliberate intent to defraud.'" (quoting *Internal Revenue Manual* § 4231 HB 933)). Once the revenue agent has interviewed the taxpayer, he must assess the taxpayer's explanation. During that process, the revenue agent may consider the proffered explanation in light of that particular taxpayer's knowledge of taxes and business practices. *See Internal Revenue Manual* § 4231 HB 940(1)(e)3.[15] In fact, one court has held that a revenue agent engages in constructive dishonesty when she continues a civil audit after receiving an incredible explanation from a taxpayer with extensive knowledge of the tax laws. *See United States v. Toussaint*, 456 F. Supp. 1069, 1071-72 (S.D. Tex. 1978).

---

[15] That subsection also gives other examples of conduct by taxpayers evidencing an intent to evade taxes: false statements, attempts to hinder examination (*e.g.*, failure to answer questions and repeated cancellations of appointments), testimony of employees regarding irregular business practices, destruction of books and records, or transfer of assets for the purpose of concealment.

Finally, a firm indication of fraud should be distinguished from a first indication of fraud. This principle is set forth clearly in the Manual:

> A firm indication of fraud must be distinguished from a first indication of fraud. A first indication of fraud can be described as a mere suspicion of fraud. Examiners are legally permitted and should endeavor to ask the taxpayer, the preparer, the representative, or any other involved party for an explanation of the "discrepancies" which are the basis of the examiners['] suspicion of fraud and any other question(s) which will resolve the question of the taxpayer's intent. The determination of firm indication of fraud is a factual determination which can only be determined on a case by case basis. An examiner who is in doubt should consult with his/her group manager and/or Examination Fraud Coordinator to determine if the indicators of fraud are sufficiently developed.

Internal Revenue Manual § 4565.21(1); *see also id.* at § 52(10)1.2(3) ("Firm indications of fraud confirm, support, and add to initial suspicions of fraud."). Revenue agents must take adequate steps to perfect indications of fraud and must ensure that the fraud is substantial prior to making a referral to the CID. *See id. at* § 52(10)1.2(3)(a)-(d); *see also* Saltzman, *IRS Practice and Procedure* ¶ 12.03[1][a]. This development is necessary because the CID must have sufficient information from which "to evaluate the criminal potential of the case." *Internal Revenue Manual* § 4231 HB 981; *see also Caldwell*, 820 F.2d at 1402-03. The courts that have addressed this issue have embraced this rule and have cautioned that "mere suspicion" should not be equated with firm indications of fraud. *See United States v. Powell*, 835 F.2d 1095, 1100 (5th Cir. 1988); *Caldwell*, 820 F.2d at 1402-03; *Groder*, 816 F.2d at 143. "[I]f a firm indication is taken to mean

the same thing as a mere suspicion, taxpayers would be subject to fraud investigations as a matter of course, and 'the revenue agent would have to cease almost before he started his investigation.'" *Caldwell*, 820 F.2d at 1397 (quoting *United States v. Lockyer*, 448 F.2d 417, 421 (10th Cir. 1971)); *see also Grunewald*, 987 F.2d at 534 ("If IRS agents, exercising sound discretion and good judgment, fear suppression of the evidence where no intentional, prejudicial misrepresentation is afoot, civil audits will prematurely and unnecessarily be referred to CID.").

We emphasize that the law of this circuit remains the test established in *Serlin*. A consensual search is unreasonable under the Fourth Amendment or violative of the due process clause of the Fifth Amendment if the consent was induced by fraud, deceit, trickery or misrepresentation by the revenue agents. For those elements to be present, the defendant must establish that the agents affirmatively misled her as to the true nature of their investigation and that this affirmative misleading was a material factor in her decision to give information to the agents. With respect to the first factor — whether affirmative misleading took place — we believe, as do the other circuits that have addressed the question, that the "firm indications of fraud" rule serves a useful function in guiding the district court's inquiry on the ultimate question as to whether there has been a deliberate misleading by the government. The foregoing discussion notes circumstances that, when present, have suggested strongly to reviewing courts that deceit and trickery amounting to such an affirmative misrepresentation have occurred. In identifying such circumstances, courts have viewed with a jaundiced eye the IRS' deviations from its own rules and regulations. That does not mean, of course, that such a deviation is sufficient, standing alone, for exclusion of evidence. *See United States v. Caceres*, 440 U.S. 741, 755-57 (1979); *see also United States v. Mapp*, 561 F.2d 685, 690 (7th Cir. 1977) (holding that rules in Internal Revenue Manual were adopted for the internal administration of

the IRS and therefore conferred no substantive rights on the taxpayer). It simply means that such deviations are relevant and probative evidence on the issue of whether the requisite affirmative misleading by the government has in fact occurred.

2.

We now apply these principles to the case at hand and address the issue of whether the revenue agents made affirmative misrepresentations to Dr. Peters concerning the nature of their investigation. In this case, we must review four stages of the IRS' civil audit of Dr. Peters: (1) Special Agent Padar's initial involvement in this case and his subsequent referral of the matter to the Examination Division; (2) Revenue Agent Thompson's investigation prior to her preparation of a fraud referral; (3) Bruce Wilson's decision to reject Thompson's referral and to continue the civil audit of Dr. Peters; and (4) the investigation of Revenue Agents Lensink and Mittl prior to their preparation of the fraud referral.

We turn first to the issue of whether the IRS engaged in affirmative deceit by conducting a civil audit of Dr. Peters after Special Agent Padar's initial involvement in the case. As we noted earlier, this case began when the CID received an "information item" from Marshall Peters, Dr. Peters' ex-husband. Padar then spoke with the informants (Marshall and his new wife), received evidence from them, drove by Dr. Peters' house to corroborate information given to him by the informants and maintained a file on Dr. Peters in the bottom drawer of his desk for 18 months. However, Padar ultimately "walked" the file across the hall to the Examination Division. Dr. Peters contends that the fact that the IRS' investigation of her began in the CID and was prompted by the informant's tip indicates that the Service had "firm indications of fraud" prior to Padar's decision to walk the file across the hall to the Examination Division. Accordingly, she asserts that the IRS violated her constitutional

rights by using the civil audit as a covert means to obtain evidence for a criminal prosecution.

The district court's finding that the IRS had not developed "firm indications of fraud" at the time Padar walked the file across to the Examination Division is not clearly erroneous.[16] The case law is clear that the fact that the investigation was prompted by an information item and therefore originated in the CID is not sufficient to establish a firm indication of fraud. *Caldwell*, 820 F.2d at 1399-1401; *Robson*, 477 F.2d at 17; *Piper*, 681 F. Supp. at 838. Indeed, it is the standard procedure of the IRS to channel information items through the CID, *see Internal Revenue Manual* § 9781 HB 3(10)3.2, and only a small number of the large quantity of information items received ever develop into fraud investigations, *see* Saltzman, *IRS Practice and Procedure* ¶ 12.03[1][c]. Moreover, in this case, there was no evidence that Padar remained involved in the investigation after it was referred to the Examination Division or that he made any

---

[16] We note at the outset that the IRS did not have an affirmative duty to warn Dr. Peters or her representatives that the audit could lead to criminal consequences or that it was prompted by an informant's tip. *See United States v. Serlin*, 707 F.2d 953, 956 (7th Cir. 1983); *see also United States v. Knight*, 898 F.2d 436, 438 (5th Cir. 1990); *United States v. Meier*, 607 F.2d 215, 216-17 (8th Cir. 1979), *cert. denied*, 445 U.S. 966 (1980); *Robson*, 477 F.2d at 17; *cf.* 26 U.S.C. § 6103(i)(6) (prohibiting the IRS from disclosing "any return or return information" that "would identify a confidential informant"); *Internal Revenue Manual* § 9373.1(1) (identity of informants must not be divulged to taxpayer under investigation).

[17] Dr. Peters makes much of the fact that, on one occasion, the informants contacted Padar with additional information after the investigation had been transferred to the Examination Division and that Padar passed this new information along to Revenue Agent Thompson. The evidence in the record shows that Padar was the passive recipient of this information and that, at the time he received it, he was no longer investigating Dr. Peters. The fact that he passed that information along to the branch of the Service currently handling the investigation hardly constitutes active involvement in the audit.

recommendations or provided any advice to the revenue agents concerning their investigation.[17] Accordingly, unlike *Tweel*, this was not a case in which a criminal law enforcement agency requested that the IRS conduct a civil audit as part of an ongoing investigation. Finally, we agree with the district court that the information provided to Padar by Dr. Peters' ex- husband was not sufficient, standing alone, to constitute a firm indication of fraud. Considering the source, there was good reason for the IRS to follow its standard procedure of perfecting first indications of fraud by, among other things, giving the taxpayer an opportunity to explain the alleged violation. *Cf. Grunewald*, 987 F.2d at 533 (after receiving tip from partner of taxpayer, revenue agent sought to determine whether the allegations were true or merely the result of animosity toward the taxpayer); *Robson*, 477 F.2d at 14 (tip called into CID by taxpayer's ex-fiancee).

We turn next to the issue of whether Revenue Agent Thompson developed "firm indications of fraud" prior to the preparation of her criminal referral. As the district court found, the record contains uncontroverted evidence that Thompson — through her words and actions — represented her audit as an ordinary or routine civil audit. Based on the record before us, we cannot conclude that the district court's finding that Thompson's representations were honest is clearly erroneous.[18] At the sup-

[18] Dr. Peters relies heavily on the fact that Thompson's supervisor, Bruce Wilson, testified that it was improper for a revenue agent to characterize her audit as "routine" or "random." Dr. Peters contends that Thompson made such characterizations in response to the inquiries of her accountant, William Morrison. However, Morrison testified that he did not remember Thompson specifically using the words "random" or "routine." Instead, he concluded that the audit was routine from the ordinary way in which Thompson was proceeding. In any event, even if Thompson did characterize the audit as "routine" during her initial meetings with Morrison, such a characterization does not amount to an affirmative misrepresentation because, as discussed above, Thompson did view the audit as routine at that time. *Cf. Piper*, 681 F. Supp. at 839 (agent's characterization of audit as "routine" did not amount to affirmative misrepresentation).

pression hearing, Thompson testified repeatedly that, in her view, the audit was routine. She testified further that her view of the audit as routine was not changed by the fact that it was a referral from the CID and had been prompted by an informant's tip. In fact, she had worked on other "informant cases" that did

---

[19] Dr. Peters also contends that Thompson misrepresented the nature of her audit by mailing her IRS Publication 1, a form entitled "Your Rights as a Taxpayer" and IRS Notice 609 ("The Privacy Act Notice") at the initiation of the audit. The IRS sends these forms to taxpayers at the inception of routine, ordinary audits, but does not mail them to the targets of a criminal investigation. As we concluded above, the district court's finding that Thompson believed herself to be engaged in a routine and ordinary civil audit is not clearly erroneous. Accordingly, to the extent her decision to mail Publication 1 was consistent with the Service's practices at the inception of a routine civil audit, it was not an affirmative misrepresentation. In addition, the documents themselves contain no statements which amount to an affirmative misrepresentation of the Service's understanding of the case at the time they were mailed.

Similarly, Dr. Peters asserts that the suppression of the evidence is required in this case based on the Taxpayer Bill of Rights of 1988 (as distinct from her constitutional arguments). *See* Pub. L. No. 100-647, §§ 6226-6247, 102 Stat. 3342, 3730-3752 (1988) (codified as amended in scattered sections of 26 U.S.C.). Section 6227 of that law required the IRS to "prepare a statement which sets forth in simple and nontechnical terms — (1) the rights of the taxpayer and the obligations of the Internal Revenue Service during an audit." *Id.* at § 6227(a). The statute further required the statement to "be distributed . . . to all taxpayers the Secretary contacts with respect to the determination or collection of any tax (other than providing tax forms)." *Id.* at § 6227(c). In response to this statutory directive, the IRS developed Publication 1. Because that document was provided to her by statutory directive, Dr. Peters asserts that any misrepresentations in Publication 1 would require suppression of the evidence obtained by the IRS during the civil audit. We note, at the outset, that the Taxpayer Bill of Rights contains no provision providing for suppression of the evidence as a remedy. However, because we conclude that Publication 1 contains no affirmative misrepresentations concerning the Service's understanding of the case at the time it was mailed, we need not decide whether the Taxpayer Bill of Rights of 1988 provides a viable ground for the suppression of evidence in a criminal tax proceeding.

not turn out to be fraud. Moreover, as we noted above, it is standard IRS procedure to route informant tips through the CID, yet few ever develop into full-scale criminal investigations.[19] Finally, Thompson testified that, at the time of her initial meeting with Dr. Peters on November 5, 1990, she had concluded that there were discrepancies in Dr. Peters' tax returns that needed to be explained but had not yet developed firm indications of fraud. Thompson's decision to interview Dr. Peters and to give her the opportunity to explain the discrepancies was consistent with both IRS procedures and the relevant case law. *See Internal Revenue Manual* §§ 4565.21(1) (distinguishing first indications of fraud from firm indications and instructing revenue agent to seek explanation from taxpayer or her representative for any discrepancies) & 4231 HB 981 (stating that revenue agent must develop initial indications of fraud prior to referral in order to provide CID with sufficient information from which "to evaluate the criminal potential of the case"); *accord Caldwell,* 820 F.2d at 1402-03; *Groder*, 816 F.2d at 143-44; *Piper*, 681 F. Supp. at 838.

The next stage of the investigation we must examine is the period immediately following Thompson's submission of her proposed referral to the CID. As we noted earlier, Thompson submitted her fraud referral to her supervisor Bruce Wilson in May 1991. However, after reviewing the case, Wilson concluded that there were not "firm indications of fraud" because Thompson had made too many errors in her analysis and had not provided Dr. Peters with an adequate opportunity to provide an explanation for the discrepancies noted by Thompson. Accordingly, the civil audit continued, albeit under the direction of two new revenue agents.

The IRS did not act improperly by continuing its audit of Dr. Peters after Thompson initiated her fraud referral in the Spring of 1991. The IRS guidelines specifically instruct revenue agents to consult with their supervisors in determining whether a

particular audit is ripe for referral to the CID. *See Internal Revenue Manual* § 4565.21(1). Moreover, there is nothing in the record which suggests that Wilson did not honestly believe that Thompson's work was faulty and needed further development and that Dr. Peters should be given further opportunity to explain the discrepancies noted by Thompson. In fact, the explanation offered by the IRS in this case is nearly identical to the one accepted by the Fifth Circuit in *United States v. Powell*, 835 F.2d 1095, 1096-97 (5th Cir. 1988). In *Powell*, an inexperienced revenue agent concluded that there were "firm indications of fraud" and began preparing a criminal referral. *See id.* However, her supervisor instructed her to perform additional tests to verify her conclusion before completing her referral. *See id.* The Fifth Circuit held that the Agency's approach in that case did not amount to fraud, deceit and trickery, but rather was consistent with guidelines set forth in the Internal Revenue Manual. *See id.* at 1101 ("We view the careful approach of the Manual as a wise and praiseworthy safeguard against the whimsical disregard of taxpayers' rights by decisions of agents who, through inexperience, might otherwise act too quickly or impetuously."); *see also Caldwell*, 820 F.2d at 1397. Similarly, in this case, we conclude that Wilson's decision to develop the audit further was consistent with the directives in the Internal Revenue Manual and was not part of an effort to conduct a covert criminal investigation.

We now turn to the final stage of the civil audit and examine the actions of Revenue Agents Lensink and Mittl prior to their referral of this matter to the CID. Based on the record before us, we cannot conclude that the district court's finding that Lensink and Mittl did not develop firm indications of fraud prior to their initiation of the criminal referral is clearly erroneous. As we noted earlier, in November 1991, Lensink asked Dr. Peters' attorney if his client would sign a consent form to extend the three-year civil statute of limitations. *See* 26 U.S.C. § 6501(a). As the district court noted, this request strongly suggests that, at that point, the IRS was still pursuing a civil case and that the

revenue agents had not yet developed "firm indications of fraud." Indeed, such an extension would be unnecessary if the Service had already made the decision to pursue either civil fraud charges (with no statute of limitations) or to commence a criminal prosecution (with a six-year statute of limitations). *See id.* at §§ 6501(c)(1) & 6531.

In light of the foregoing discussion, we conclude that the district court's finding that the IRS did not engage in affirmative deceit during its audit of Dr. Peters is not clearly erroneous.[20] In addition, we note that the district court's legal analysis of this issue was guided by sound principles. The court properly looked to both the internal guidelines of the IRS and the existing case law.

B.

We turn now to Dr. Peters' contention that the evidence presented at trial was not sufficient to support the jury's verdict. First, with respect to Counts I and III, which charged Dr. Peters with making false statements on her corporate returns, she contends that the government's proof was insufficient because, at trial, the government calculated her taxes using a method of accounting different from the method used by her accountant in preparing her corporate returns. Second, with respect to Counts II and IV, which charged Dr. Peters with making false statements on her personal returns, she asserts that the government's proof was insufficient because the government failed to present any proof that the unreported income diverted from her corporation represented taxable "constructive dividends" rather than non-taxable return of capital. In evaluating Dr. Peters' challenges to the sufficiency of the evidence, we review the evidence in the light most favorable to the government and shall reverse only if

---

[20] Accordingly, we need not reach the second prong of the *Serlin* inquiry — whether the agents' representations were material to Dr. Peters' decision to cooperate with the IRS during the audit.

no rational jury could have found Dr. Peters guilty beyond a reasonable doubt. *See United States v. Jean*, 25 F.3d 588, 595 (7th Cir. 1994).

1. Counts I & III: Accrual v. Cash Basis

Dr. Peters contends that the government's evidence with respect to Counts I and III (charging her with making false statements on her 1988 and 1989 corporate returns) was not sufficient to support the jury's verdict because the government's proof used a different method of accounting from that used by her accountant. The government used the cash basis method of accounting to make its case against Dr. Peters; however, she asserts that her accountant used the accrual method. In making this argument, Dr. Peters points to her corporate tax returns. On those returns, her accountant clearly checked the box indicating that the corporation was an accrual basis taxpayer. However, despite the marking on the return, Dr. Peters' accountant testified repeatedly that he used the cash basis method to prepare her corporate returns. This conflicting evidence was put before the jury during the course of the trial, and it chose to credit the accountant's testimony that Dr. Peters was in fact a cash basis taxpayer. We shall not second-guess the jury's determination on appeal.

2. Counts II and IV: Constructive Dividends

Dr. Peters' second contention involves Counts II and IV, which charged her with making false statements on her individual returns. In those counts, the government alleged that Dr. Peters diverted corporate funds into her personal accounts and that she made corporate expenditures for her personal benefit. These funds were not reported on either her corporate or personal return. Dr. Peters contends that the government failed to prove that she received such income because it did not prove that her corporation had sufficient earnings and profits in the relevant

years to pay "constructive dividends." In her view, the government was required to put forward such proof in order to show that any diverted funds constituted taxable income to her rather than nontaxable return of capital.

In making this argument, Dr. Peters relies on the rule used in several civil tax cases involving the proper characterization of corporate funds which have been diverted to the sole shareholder of a wholly-owned corporation. In such a case, the government must provide evidence of corporate earnings and profits to show that the money "skimmed" by the taxpayer was a taxable "constructive dividend" as opposed to nontaxable return of capital. *See e.g., Truesdell v. Commissioner*, 89 T.C. 1280, 1298 (T.C. 1987). However, the majority of courts that have addressed this same situation in the context of a criminal proceeding have held that the government need not prove the character of the diverted funds. *See United States v. Williams*, 875 F.2d 846, 849-52 (11th Cir. 1989); *United States v. Miller*, 545 F.2d 1204, 1213-14 (9th Cir. 1976), *cert. denied*, 430 U.S. 930 (1977); *Davis v. United States*, 226 F.2d 331, 335-36 (6th Cir. 1955), *cert. denied*, 350 U.S. 965 (1956). These cases have stressed the distinction between the nature of a civil collection action and a criminal tax proceeding:

> In civil tax cases the purpose is tax collection and the key issue is the establishment of the amount of tax owed by the taxpayer. In a criminal tax proceeding the concern is not over the type or the specific amount of tax which the defendant has evaded, but whether he has willfully attempted to evade the payment or assessment of tax.
>
> The difficulty in automatically applying the constructive distribution rules to this case is that it completely ignores one essential element of the crime charged: the willful intent to evade taxes, and concentrates solely on the nature of the funds diverted. That latter aspect is not the important

element. Where the taxpayer has sought to conceal income by filing a false return, he has violated the tax evasion statutes.

Miller, 545 F.2d at 1214; *see also Williams*, 875 F.2d at 850.

The Second Circuit recently has taken a view different from that expressed in *Williams*, *Miller* and *Davis*. *See United States v. D'Agostino*, 145 F.3d 69, 72-73 (2d Cir. 1998). In *D'Agostino*, the taxpayers argued that they did not owe any tax on the diverted corporate funds because those funds were not constructive dividends. The taxpayers further asserted that the diverted funds could not be constructive dividends because the corporation had no earnings and profits in the years in question and therefore must constitute a reduction in the taxpayer's loan account or capital account with the corporation. Because there was no tax deficiency, there could be no violation. By contrast, the government argued, per *Williams*, that whether the diverted funds constitute personal income or corporate income depends on the intent of the taxpayer at the time the funds are diverted. If the intent is to evade taxes, the income is personal and taxable. If the intent is to take a reduction under the loan account or capital account, then the funds are not taxable. The Second Circuit took the view of the defendants and followed their precedent in civil

---

[21] That section provides:

§ 7201. Attempts to evade or defeat tax.

Any person who willfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more than $100,000 ($500,000 in the case of a corporation), or imprisoned not more than 5 years, or both, together with the costs of prosecution.

[22] The taxpayer in *Miller* was charged with violations of both §§ 7201 and 7206(1). *See* 545 F.2d at 1212. Yet, the court's determination that the government need not put on evidence of earnings and profits in a criminal case applied to prosecutions under either statute. *See id.* at 1214.

cases that required the government to put on earnings and profits evidence in this type of case. *See id.* at 73.

D'Agostino and the other criminal cases we have just discussed involved alleged violations of 26 U.S.C. § 7201,[21] which requires the existence of a tax deficiency.[22] By contrast, § 7206(1)[23] requires only that the taxpayer file a return "which he does not believe to be true and correct as to every material matter." Indeed, this court has recently held that the government need not prove an actual tax deficiency in order to convict a defendant under § 7206(1). *See United States v. Minneman*, 143 F.3d 274, 279 (7th Cir. 1998); *accord United States v. Marashi*, 913 F.2d 724 (9th Cir. 1990); *United States v. Wilson*, 887 F.2d 69 (5th Cir. 1989); *United States v. Miller*, 491 F.2d 638 (5th Cir.), *cert. denied*, 419 U.S. 970 (1974). Rather, the elements of a § 7206(1) violation are: (1) that the defendant made or caused to be made, a federal income tax return for the year in question which he verified to be true; (2) that the tax return was false as to a material matter; (3) that the defendant signed the return willfully and knowing it was false; and (4) that the return contained a written declaration that it was made under the penalty of perjury. *See United States v. Whyte*, 699 F.2d 375, 381 (7th Cir. 1983). A false statement is "material" when it has "the potential for hindering the IRS's efforts to monitor and verify the tax liability" of the corporation and the taxpayer. *United States v. Greenberg*, 735 F.2d 29, 32 (2d Cir. 1984). Here, the evidence showed that Dr. Peters diverted corporate funds directly to a personal account and that these funds were not accounted for in any way.

The focus of § 7206(1) is clearly on the taxpayer's intent. Here, there is no evidence in the record indicating that Dr. Peters intended the distributions at issue to be a return of capital. The

---

[23] *See supra* note 1.

record shows, however, a consistent pattern of diverting corporate funds into her personal accounts and making corporate expenditures for her personal benefit. Such a pattern is sufficient evidence to support the jury's conclusion that Dr. Peters filed tax returns which she did not "believe to be true and correct as to every material matter." 26 U.S.C. § 7206(1). Accordingly, we hold that the government was not required to present evidence concerning the earnings and profits of Dr. Peters' corporation in order to convict her of a violation of § 7206(1).

Conclusion

For the reasons stated in the foregoing opinion, we affirm the judgment of the district court.

AFFIRMED

EASTERBROOK, *Circuit Judge*, concurring. Peters, who turned records over to the IRS in an audit, wants to prevent their use in this criminal prosecution because, she insists, the IRS had "firm indications of fraud" on her part before or during the audit. She advances two propositions. The first is that acquisition of evidence must cease once the IRS acquires enough information to refer the case to a criminal prosecutor. The second is that "firm indications of fraud" are inconsistent with a representation that the audit is "civil", rendering cooperation involuntary and the acquisition of documents a violation of the fourth amendment. (Peters also invokes the due process clause of the fifth amendment, but it is inapplicable to the seizure of evidence. *Sacramento v. Lewis*, 118 S. Ct. 1708, 1715 (1998); *Graham v. Connor*, 490 U.S. 386 (1989). *Cf. Fisher v. United States*, 425 U.S. 391 (1976) (no fifth amendment privilege in the contents of business records).) Although decisions can be found that accept both of these propositions, the first is antithetical to the fourth amendment and the second problematic.

Probable cause to believe that a crime has been committed is

the constitutional requirement for a warrant; it is not an objection to a seizure. Why should a solid basis for believing that the suspect has committed a crime require the government to curtail its investigation? "Law enforcement officers are under no constitutional duty to call a halt to a criminal investigation the moment they have the minimum evidence to establish probable cause, a quantum of evidence which may fall far short of the amount necessary to support a criminal conviction." *Hoffa v. United States*, 385 U.S. 293, 310 (1966). Peters relies heavily on statements in IRS publications that instruct auditors to hand cases over to their criminal counterparts when evidence begins to build — this is where the phrase "firm indications of fraud" comes from — but *United States v. Caceres*, 440 U.S. 741 (1979), holds that the IRS's violation of its own rules or procedures for conducting investigations does not justify use of the exclusionary rule. *See also United States v. Mapp*, 561 F.2d 685 (7th Cir. 1977). What is more — and dispositive — is *Beckwith v. United States*, 425 U.S. 341 (1976), which holds that so far as the Constitution is concerned revenue agents may interrogate and gather evidence from taxpayers who the IRS believes have engaged in criminal wrongdoing.

Although the Constitution permits agents to keep gathering evidence long after they have "firm indications" of crime, Congress has blocked the use of one investigative tool. While "a Justice Department referral is in effect" it is not possible to enforce a summons for tax records. 26 U.S.C. § 7602(c)(1); *United States v. Michaud*, 907 F.2d 750 (7th Cir. 1990) (en banc). This rule offers Peters no aid — first because the case was not "referred" to the Department of Justice until after the audit (see the definition of "referral" in § 7602(c)(2)), and second because a limitation on compulsory process does not imply a limitation on voluntary production. Agents are entitled to ask, however much (*see Beckwith*) or little (*see Florida v. Bostick*, 501 U.S. 429 (1991)) evidence they possess. Taxpayers may find

cooperation in their interests no matter how far along the road toward criminal prosecution the IRS has traveled; cooperation with auditors and prompt payment of civil penalties has staved off many a tax prosecution. So there is nothing to Peters' contention that "firm indications of fraud" oblige the IRS to stop inquiring and require the suppression of evidence voluntarily disclosed.

Was disclosure voluntary? If a revenue agent uses deceit to get a taxpayer to turn over documents that could not have been secured either by a summons under 26 U.S.C. § 7602(b) or by a search warrant, it might make sense to suppress the results in order to ensure that the statutory line is honored. But what role would "firm indications of fraud" play in such an inquiry? The statutory question is whether the case has been referred for criminal prosecution, not whether the IRS has "firm indications of fraud". As for the constitutional standard: although the validity of consent obtained by overstating the weight of evidence in hand — making it look to the suspect like the jig is up, so there is no point in resisting — is questionable, why would understating the weight of existing evidence imperil voluntariness? A suspect who believes that the IRS lacks the evidence to commence a criminal prosecution, but who knows that records will furnish what the IRS needs, has powerful reasons to withhold consent. If despite this the suspect provides tax records, it is hard to see how the decision could be called involuntary. Law enforcement agencies are understandably reluctant to tell suspects what evidence they have gathered (indeed, they do not have to provide this information even after prosecution has begun). How can reticence about the weight of evidence the government possesses overbear a suspect's free will and prevent rational decision-making? That is the standard of voluntariness. *Ohio v. Robinette*, 117 S. Ct. 417 (1996); *Schneckloth v. Bustamonte*, 412 U.S. 218 (1973); *Rogers v. Richmond*, 365 U.S. 534 (1961); *United States v. Rutledge*, 900 F.2d 1127, 1130-31 (7th Cir.

1990). Peters knew that the IRS questioned the accuracy of information on her returns and that disclosure might either quell its doubts or reinforce them; she knew that she was entitled to withhold consent and force the IRS to use a summons, which she could resist in court; she had and used an opportunity to consult an accountant and could have consulted a lawyer as well. A person in Peters' position can make a rational choice among known risks and opportunities, and the election therefore properly may be called voluntary. *Schneckloth* holds that a consent to search may be voluntary even when the suspect is unaware that he is entitled to refuse; Peters' decision was much better informed than Bustamonte's (or Robinette's).

My colleagues opine that consent following an agent's misstatement about the weight of existing evidence is involuntary. Several of our cases say that a suspect in a tax case cannot have the evidence suppressed unless he shows, by clear and convincing evidence, that material misstatements of fact undercut the voluntariness of the consent to search. *United States v. Serlin*, 707 F.2d 953, 956 (7th Cir. 1983); *United States v. Lehman*, 468 F.2d 93, 105 (7th Cir. 1972); *cf. United States v. Stern*, 858 F.2d 1241, 1249 (7th Cir. 1988). None of these holds, however, that agents' deceit compels a finding of involuntariness, for in each case the court held that the evidence was properly admitted. To hold that X, Y, and Z are necessary conditions of suppression is not to hold that they are sufficient. "[A]t least since *Schneckloth v. Bustamonte*, it cannot be said that . . . deception [about the purpose of the investigation] is inherently incompatible with consent, for in *Schneckloth* the Court adopted the voluntariness test from the coerced confession cases, which has not been deemed to compel the exclusion of statements obtained by police misrepresentation of the crime under investigation." Wayne R. LaFave, 3 *Search and Seizure: A Treatise on the Fourth Amendment* § 8.2(n) at 710 (3d ed. 1996) (footnotes omitted). A statement's voluntariness is not undercut by the fact that the speaker was unaware that he was a target (unaware, that is, that

the prosecutor had "firm indications" of his criminal conduct). *See United States v. Washington*, 431 U.S. 181, 188-90 (1977); *United States v. Mandujano*, 425 U.S. 564 (1976); cf. *United States v. Wong*, 431 U.S. 174 (1977). If a misunderstanding of one's status as a target — misunderstanding abetted by calculated silence and half-truths from agents and prosecutors — does not invariably make a statement involuntary, why should it make a disclosure of physical evidence involuntary?

Police engage in deceit all the time in order to induce suspects to reveal evidence. Think of the undercover officer posing as a buyer of drugs. Much evidence is properly acquired by concealing a person's status as an agent of law enforcement. E.g., *On Lee v. United States*, 343 U.S. 747 (1952); *Hoffa*, 385 U.S. at 300-03; *Lewis v. United States*, 385 U.S. 206 (1966); *see also* LaFave, *Search and Seizure* § 8.2(m). Deception plays an important and legitimate role in law enforcement. Even chicanery that creates the crime being prosecuted is constitutionally tolerable. *See United States v. Murphy*, 768 F.2d 1518, 1528-29 (7th Cir. 1985). If dissimulation so successful that the suspect does not know that he is talking to an agent is compatible with voluntariness, how could there be a rule that misdirection by a known agent always spoils consent? Professor LaFave is rightly puzzled by courts' greater willingness to suppress evidence when agents who reveal their status give deceptive answers to inquiries about the purpose of the investigation than when agents lie about their status as agents.

One of these days the Supreme Court will confront the tension between these lines of cases. All that matters today, however, is that lack of candor about the purpose of an investigation is no more fatal to a consent search than it is to a confession — and that in either case the court of first instance must take all of the circumstances into account. Any attempt to separate "firm indications of fraud" from "first indications of fraud" — the

distinction my colleagues suggest — is a snipe hunt, for reasons developed in *Hoffa* and reiterated in *Beckwith*. Because voluntariness of a consent is a question of "fact" whose resolution by the trier of fact is subject to deferential appellate review, our role is limited. *Robinette*, 117 S. Ct. at 421; *Schneckloth*, 412 U.S. at 248-49; *United States v. Chi Fa Chan*, 136 F.3d 1158 (7th Cir. 1998); *United States v. Sholola*, 124 F.3d 803, 819 n.16 (7th Cir. 1997); *United States v. Shelby*, 121 F.3d 1118, 1120 (7th Cir. 1997); *United States v. Yusuff*, 96 F.3d 982, 986 (7th Cir. 1996); *United States v. Stribling*, 94 F.3d 321, 323-24 (7th Cir. 1996). The district judge found that Peters' consent was voluntary because the agents did not deceive her. That finding is not clearly erroneous. No more is necessary to resolve the appeal. If and when, in some future case, a judge concludes that agents prevaricated but that consent was nonetheless voluntary, our review should be equally deferential.

A true Copy:

Teste:

_____

Clerk of the United States Court of Appeals for the Seventh Circuit

APPENDIX B

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

No. 95 CR 0216

UNITED STATES OF AMERICA,
Plaintiff,

v.

FLORENCE L. PETERS,
Defendant.

Judge George W. Lindberg

[DOCKETED: October 22, 1996]

MEMORANDUM OPINION AND ORDER

Defendant, Dr. Florence L. Peters, is the subject of a five count indictment for tax fraud. She now moves to suppress records and statements that she offered to IRS auditors in the months between April, 1990 and January, 1992. Dr. Peters claims that the IRS obtained this evidence in violation of her Fourth and Fifth Amendment rights by telling her that they were conducting a routine civil audit when in fact they were carrying out a criminal investigation. For the reasons set forth below, defendant's motion to suppress is denied.

TAX INVESTIGATIONS

This case unmasks the investigative techniques employed by the Internal Revenue Service. Its principle players are the Criminal Investigation Division and the Examination Division of the IRS, two organizations charged with enforcing the nation's tax laws. A brief introduction to these institutions sets the stage for the factual recitals to follow.

As its name suggests, the Criminal Investigation Division (CID) ferrets out criminal violations of the tax code and related federal statutes. A criminal tax offense generally entails a substantial level of underpayment paired with some intent to defraud the government. *See* 26 U.S.C. § 7201 *et seq.* Due to the nature of its investigations, the CID wears the raimants of a criminal law enforcement agency. CID operatives are called special agents, and they carry guns and badges. Moreover, special agents must read the following administrative warning before they solicit information from taxpayers:

> As a special agent, one of my functions is to investigate the possibility of criminal violations of the Internal Revenue laws, and related offenses. ... [U]nder the Fifth Amendment of the Constitution of the United States I cannot compel you to answer any questions or to submit any information if such answers or information might tend to incriminate you in any way. I also advise you that anything which you say and any information which you submit may be used against you in any criminal proceeding which may be undertaken. I advise you further that you may, if you wish, seek the assistance of an attorney before responding.

Beckwith v. United States, 425 U.S. 341, 343 (1976), *quoting* IRS News Release No. 897 (1967) and IRS News Release IR-949 (1968). All of this regalia is occasioned by the fact that the subject of a CID investigation may end up in jail.

The Examination Division of the IRS is responsible for conducting civil tax audits. A civil audit is an investigative procedure used to determine whether an individual has paid all of his or her taxes. *Cohen v. United States*, 405 F.2d 34, 35 n.3 (8th Cir. 1968). When an audit reveals evidence of underpayment, the IRS generally enters a civil settlement with the taxpayer consisting of repayment and possible monetary penalties. For this reason, the Examination Division does not present itself

as a criminal law enforcement agency. Civil audits are conducted by revenue agents, who, unlike special agents, do not carry guns and are not required to provide administrative warnings. *United States v. Tweel*, 550 F.2d 297, 299-300 (5th Cir. 1977) (only special agents are required to provide administrative warnings); *United States v. Piper*, 681 F. Supp. 833, 839 (M.D.Ga. 1988) ("[R]evenue agents, unlike special agents, have no duty either to provide Miranda-like warnings or to advise taxpayers that a routine civil audit may lead to criminal proceedings").

The functional distinction between the CID and the Examination Division blurs, however, when it is considered that a civil audit may produce sufficient evidence of criminal activity to send a person to prison. *Piper*, 681 F. Supp. at 838 ("[A] routine civil audit may in any situation lead to criminal proceedings"). The Examination Division may refer a case to the CID for a criminal investigation whenever it uncovers firm indications of fraud by the taxpayer. The IRS regulations provide that

> [i]f, during an examination, an examiner discovers a firm indication of fraud on the part of the taxpayer, the tax return preparer, or both, the examiner shall suspend his/her activities at the earliest opportunity without disclosing to the taxpayer ... the reason for such suspension.

Internal Revenue Manual § 4565.21(1) (hereinafter IRM); *see also Piper*, 681 F. Supp. at 838 ("[A] civil examination should be halted upon a finding of 'firm indications of fraud'"). When this occurs, the taxpayer cannot escape criminal sanctions by offering to repay his or her debt.

Statistically, civil audits lead to criminal prosecutions in only a very small number of cases each year. In 1994, the IRS audited only about 1.25 million of the 114.88 million individual returns filed. U.S. Department of Treasury, Internal Revenue Service, *Data Book 1993-1994* 89, 96 (1995). In that same year, the CID

initiated 5,346 criminal investigations, and these resulted in 3,130 criminal convictions. *Id.* at 103. In 1989, only about 19 percent of the CID investigations began with referrals from other divisions of the IRS, although this number was as high as 50 percent in 1978. Michael I. Saltzman, *IRS Practice and Procedure* 12-9 (1991). These figures suggest that, while the Examination Division does not function primarily as a criminal law enforcement agency, there are some cases where it does. Indeed, this is one such case.

The Internal Revenue Manual distinguishes a "firm indication" from a "first indication" or "mere suspicion" of fraud. IRM § 4565.21(1); *see also Groder v. United States*, 816 F.2d 139, 143 (4th Cir. 1987), and *Piper*, 681 F. Supp. at 838. The purpose of this rule is to permit revenue agents to substantiate or "perfect" preliminary indications of fraud by ruling out, through an audit, possible innocent explanations for faulty returns. *See United States v. Caldwell*, 820 F.2d 1395, 1402-1403 (5th Cir. 1987) (firm indications rule permits agents "to develop the case in sufficient detail to be sure there is not an innocent explanation for unreported income and to develop the case sufficiently to allow CID to determine whether a criminal investigation is warranted"); *United States v. Kaatz*, 705 F.2d 1237, 1243 (l0th Cir. 1983) (revenue agent need not refer case to CID in the face of unanswered questions); *Piper*, 681 F. Supp. at 838 (Examination Division must "preclude innocent explanation for unreported income" before referring to CID); *see also* Saltzman at 12-10 (revenue agents perfect indications of fraud by "examining books and records that may later be unavailable to the IRS").

The Seventh Circuit described the firm indications rule in *United States v. Mapp*, where it held that

> while a revenue agent might know of fraud, he must still, in his discretion, decide when the investigation has progressed to the point at which he has enough information so

> that the Intelligence Division can make an informed decision on whether or not to undertake a criminal investigation.

561 F.2d 685, 690 (7th Cir. 1977). In *Groder*, the Fourth Circuit explained the reasoning behind the rule as follows:

> If a firm indication is taken to mean the same thing as a mere suspicion, taxpayers would be subject to fraud investigations as a matter of course, and the revenue agent would have to cease almost before he started his investigation.

816 F.2d at 143 (quotations omitted); *accord Caldwell*, 820 F.2d at 1402, *United States v. Powell*, 835 F.2d 1095, 1100 (5th Cir. 1988), and *Piper*, 681 F. Supp. at 838.

The question of whether certain evidence constitutes a firm indication of fraud is "a factual determination which can only be [made] on a case by case basis." IRM § 4565.21(1). In making this determination, revenue agents must look to the so-called "badges of fraud" listed in the Internal Revenue Manual. IRM § 940; *see also Powell*, 835 F.2d at 1097 n.7. The decision that certain "badges of fraud" constitute a firm indication of fraud is almost exclusively within the discretion of the supervisory Examination Division personnel. *See Mapp*, 561 F.2d at 690 (evaluation of evidence underlying fraud referral is discretionary); *Powell*, 835 F.2d at 1100-1101 (timing of fraud referral under IRM § 4565.21 is discretionary and requires a revenue agent to "consult with his/her group manager ... to determine if the indicators of fraud are sufficiently developed"), *Caldwell*, 820 F.2d at 1402 (referral to CID is discretionary and there are "no absolute criterion established for when an investigation should be suspended and the case referred for criminal investigation"), *Groder*, 816 F.2d at 143 (timing of CID referral is discretionary), and *Piper*, 681 F. Supp. at 838 ("[T]he decision to refer a matter from the civil division to the CID is a discretionary one").

In addition to being referred by the Examination Division or some other agency in the IRS, a criminal tax investigation may be prompted by an information item or "tip" from another law enforcement agency or from the public. The IRS receives up to 200,000 information items each year. Saltzman at 12-12. Of these, however, only a very small number develop into fraud investigations; most do not contain sufficient evidence to justify a full-scale criminal investigation. Saltzman at 12-15. Despite the fact that very few information items develop into criminal investigations, the IRS encourages the public to submit such information items directly to the CID. *United States v. Robson*, 477 F.2d 13, 17 (9th Cir. 1973) ("Every informant's tip received by the IRS comes through the [CID, yet] not every tip results in an investigation").

Upon receiving an information item, the CID reviews it and determines whether it should be retained for a criminal investigation or referred for a civil tax audit. *See generally* IRM § 9311; *see also* Saltzman at 12-12. If the CID decides to retain a case, it may initiate a full investigation or assign the case to a special agent for a limited primary investigation. IRM §§ 9311.2, 9311.3(2); *see also* Saltzman at 12-20 to 12-21. If, however, the CID determines that a case has a "firm indication of substantial civil tax potential" but has no criminal potential, then it may refer the case to the Examination Division for a civil tax audit. IRM § 9311.83(2); *see also* Saltzman at 12-21.

In this case, IRS officials testified that information items trigger immediate criminal investigations only very rarely, as they are usually routed to the Examination Division for civil audits. The CID generally retains information items only when it has a preexisting case file on the taxpayer or some other special interest in the case. Once an information items reaches the Examination Division, it may be disregarded if it does not promise a significant tax recovery.

Prior to every civil audit, the IRS gives the taxpayer two documents that are of particular relevance here. The first, which is entitled "Your Rights as a Taxpayer," informs taxpayers that they have the right "to know why we are asking you for information, exactly how we will use any information you give, and what might happen if you do not give information." Department of Treasury, Internal Revenue Service, Publication 1, "Your Rights as a Taxpayer," ¶ 9 (June 1989). It explains that taxpayers may be represented by an attorney. *Id.* at ¶ 13. It further represents that "[w]henever you owe tax ... [w]e will not take any enforcement action ... until after we have tried to contact you and given you the chance to voluntarily pay any tax due." *Id.* at ¶¶ 18, 26.

The second document, the Privacy Act Notice, includes the following statement warning taxpayers about the possibility of criminal prosecution:

> If you do not file a return, do not provide the information we ask for, or provide fraudulent information, the law says that you may be charged penalties and, in certain cases, you may be subject to criminal prosecution.

Department of the Treasury, Internal Revenue Service, "Notice 609: Privacy Act Notice," ¶ 7 (June 1989). The publication also notifies the taxpayer that the information collected in a civil audit may be shared with the Department of Justice, as well as with other federal, state, and municipal agencies. *Id.* at ¶ 6.

FACTUAL BACKGROUND

The tax investigation of Dr. Peters began in 1988, when her ex-husband Marshall Peters placed a telephone call to the IRS to report her allegedly improper tax reporting practices. The call was received by Special Agent Gerald Padar of the CID, who set up an appointment to meet personally with Mr. Peters on October 6, 1988. After the meeting, Mr. Peters sent Padar

photocopies of over 500 checks that defendant allegedly wrote for personal expenses but deducted as business expenses.

In Padar's estimation, this information amounted to nothing more than an "unsubstantiated allegation of fraud" which did not warrant a full criminal investigation. For almost eighteen months, then, Padar did nothing to pursue an investigation beyond reading over the documents provided by Mr. Peters and conducting a single drive-by surveillance of defendant's home. He neither opened an official case file nor contacted defendant personally. Padar later explained that he was reticent to launch an investigation because there were numerous reasons why defendant's allegedly improper expenses might prove to be legitimate, and also because the origin of the tip cast some doubt on its veracity. Padar ultimately carried the Peters file across the hall to the Examination Division when the IRS moved its offices in January or February of 1990. He had no further connection with the case.

The file then fell into the hands of Thomas Ridgeway, a group manager in the Examination Division. Like Padar, Ridgeway did not regard the information provided by Mr. Peters to constitute a firm indication of fraud. Rather, he characterized the file as "unsubstantiated paper" and "300 pages of nothing." He did, however, determine that the case promised a sufficient tax recovery to merit a civil audit.

In March or April of 1990, then, Ridgeway assigned the case to an inexperienced revenue agent named Margo Thompson, who reviewed the CID file and initiated a civil audit. Thompson was aware that the case had been prompted by an information item and referred by the CID. She did not, however, have any contact with the CID during the course of the audit. Like Padar and Ridgeway before her, Thompson did not see anything in the file which she construed as a firm indication of fraud. She had,

in fact, worked with other cases that were prompted by information items but did not evolve into criminal investigations.

Thompson initiated the first IRS contact with Dr. Peters on July 2, 1990. On that date, Thompson sent a standard form letter to Dr. Peters indicating that defendant's 1987 and 1988 corporate tax returns had been selected for a civil audit. Enclosed in the letter were the Privacy Act Notice and the document entitled "My Rights as a Taxpayer." The letter contained no indication that the audit had been prompted by an information item or that the case had been referred by the CID.

Commencing in September of 1990, Thompson conducted a series of personal meetings and telephone contacts with William Morrison, an accountant and tax expert who had worked with Dr. Peters for almost ten years. Thompson first met with Dr. Peters for approximately two hours on November 5, 1990, shortly after finding an apparent discrepancy of approximately $100,000 in her tax filings. At this time, Thompson did not believe that she had gathered sufficient evidence to constitute a firm indication of fraud. As of February, 1991, Morrison himself did not have any indication that the case might have criminal potential.

In the course of these communications, Morrison testified, he asked Thompson whether she was conducting a "routine" or "ordinary" audit, and she replied in the affirmative. Beyond this, Thompson never revealed to defendant or her agents that the audit had been prompted by an information item or referred by the CID. Nor did she provide a verbal warning that defendant might be subject to criminal prosecution. Morrison testified that he would have discontinued the audit and advised his client to retain an attorney if he had known any of these facts during the fall of 1990.

In April, 1991, Thompson concluded her audit and began to compose a fraud referral. The following month, however, she reviewed the case with her new supervisor Bruce Wilson, and he

concluded that the audit contained too many procedural errors to substantiate a fraud referral. In particular, Wilson believed that Thompson had disallowed certain classes of deductions without investigating whether Dr. Peters could explain them and, as a result, that the IRS was obliged to reexamine defendant's expenses de novo. In short, Wilson decided that Thompson's papers "proved nothing." Although Wilson was unwilling to make a fraud referral, he nevertheless believed that Thompson's analysis had uncovered preliminary indications of fraud that should be followed up with a bank deposit analysis.

The cast of characters broadened in July of 1991, when defendant retained the services of an attorney named Ben Roth and the Examination Division reassigned the audit to Revenue Agents Cynthia Lensink (then Geronome) and Steven Mittl. Lensink met personally with both Morrison and Roth on November 4, 1991. During that meeting, Roth advised his client to sign a consent form extending the window of time in which the IRS might settle or prosecute the case. Revenue Agent Lensink stated that she wished to close the audit expeditiously and had prepared a list of proposed "adjustments" for that purpose, statements which both Roth and Morrison interpreted as referring to a civil settlement rather than to a criminal prosecution. Lensink said nothing to indicate that Thompson had prepared an abortive fraud referral, that the audit had been prompted by an information item, or that the case had originated with the CID.

Roth testified that he asked Lensink during the meeting on November 4, 1991, whether the case might be referred for criminal prosecution, and that she replied in the negative. Lensink, however, testified that Roth never asked her this question and that she never denied the possibility of criminal prosecution. In support of her testimony, Lensink produced exhaustive notes of the meeting on November 4th, notes which made no reference to this very significant interchange.

Regardless of the status of the investigation on November 4, 1991, the Examination Division had a firm indication of fraud by the end of December, when it referred the case to the CID for a criminal investigation. Morrison and Roth first learned of the referral in January of 1992. The CID ultimately recommended criminal prosecution of defendant based on the information that she provided to the IRS during her audit. The instant five-count indictment ensued.

Defendant now alleges that the government tricked her into believing that the audit was exclusively civil in nature when in fact it was at all times a criminal investigation. She further claims that the government fraudulently induced her cooperation in the audit by failing to warn her that it had been prompted by an information item and might lead to criminal sanctions. Consequently, she argues, the evidence obtained through her audit must be suppressed.

The court conducted a suppression hearing that stretched over six trial days. After thoroughly reviewing the testimony and pleadings offered by the parties, toge her with the relevant case law, the court now denies defendant's motion to suppress.

DISCUSSION

In 1921, the Supreme Court explained that the Fourth and Fifth Amendments require the suppression of evidence obtained by government agents through "stealth." *Gouled v. United States*, 255 U.S. 298, 305-306 (1921). This rule bars the use of evidence obtained in a consensual IRS audit "if the consent was induced by deceit, trickery, or misrepresentation." *Tweel*, 550 F.2d 299; *accord Powell*, 835 F.2d at 1098, *Caldwell*, 820 F.2d at 1399, *Cardwell v. Kurtz*, 765 F.2d 776, 780 (9th Cir. 1985), and *Robson*, 477 F.2d at 17; *but see Lewis v. United States*, 385 U.S. 293 (1966), and *United States v. Walker*, 760 F.2d 144, 146 (7th Cir. 1985) (allowing undercover agents to make misrepresentations).

In order to prevail on her motion, defendant must show by clear and convincing evidence that the agents "affirmatively misled [her] as to the true nature of the investigation" and that the misinformation was "material in [her] decision to speak with the agents." *United States v. Serlin,* 707 F.2d 953, 956-957 (7th Cir. 1983); *accord United States v. Stern*, 858 F.2d 1241, 1249 (7th Cir. 1988), *Caldwell*, 820 F.2d at 1399, *United States v. Gruenwald*, 987 F.2d 531, 534 (8th Cir. 1993), and *United States v. Wuagneux*, 683 F.2d 1343, 1347 (11th Cir. 1987). In the end, however, the court must "examine the entire record and make an independent determination of the ultimate issue of voluntariness." *Beckwith*, 425 U.S. at 348, *cited Serlin*, 707 F.2d at 956, and *Mapp*, 561 F.2d at 688. In any case, the "remedy [of suppression] is suggested only for fairly serious affirmative [mis]representations," *United States v. Irvine*, 699 F.2d 43, 35 (lst Cir. 1983), and "the suppression burden is indeed a heavy one," *Powell*, 835 F.2d at 1099.

As a threshold matter, then, the court must decide whether the civil revenue agents affirmatively misrepresented the nature of their investigation to Dr. Peters. To do this, the court must consider, first, whether the civil audit conducted by the revenue agents was in fact a covert criminal investigation; second, whether the agents had a duty to warn defendant that the audit might result in criminal penalties; and, third, whether the agents had a duty to reveal that the audit was prompted by an information item.

A.

Defendant contends that the revenue agents affirmatively misrepresented that they were conducting a routine civil audit when in fact they were engaged in a criminal investigation. It is well established that an "affirmative representation by an IRS agent that [an] investigation is routine when in fact it is a criminal investigation requires suppression of evidence."

United States v. Nuth, 605 F.2d 229, 234 (6th Cir. 1979); *accord Serlin*, 707 F.2d at 957. The purpose of this rule is to prevent the IRS from developing a criminal investigation under the guise of a civil audit. IRM § 9311.83.

The leading authority in this arena is *Tweel*, 550 F.2d 297. In that case, the Fifth Circuit required revenue agents to disclose, when asked, that their audit was ordered by the Justice Department in conjunction with an ongoing criminal investigation of the taxpayer. *Id.* at 298. In an attempt to discern whether the audit was part of a criminal investigation, the defendant's accountant asked the revenue agents whether a special agent was assigned to the case. *Id.* Although the auditors answered literally that there were no special agents involved, the court characterized their response as a "sneaky deliberate deception" and a "flagrant disregard for [the defendant's] rights." *Id.* at 298-299. It denounced the agents' conduct as a "shocking" violation of the "good faith ... [that] the taxpayers should be able to expect ... from the government in its enforcement and collection activities." *Id.* at 300.

In this case, there is uncontroverted evidence that the revenue agents characterized their investigation as an ordinary or routine civil audit. The very first communication that defendant received from the government was a standard form letter dated July 2, 1990, indicating that she had been selected for a civil audit. In the course of the investigation, Revenue Agent Thompson told Morrison that she was indeed engaged in a routine civil audit. Later, during the summer and fall of 1991, Revenue Agent Lensink informed Morrison and Roth she wished to close the audit expeditiously and had prepared proposed "adjustments" to that end. Both Roth and Morrison believed that Lensink was referring to a civil settlement rather than to criminal prosecution.

In order to determine whether these communications were affirmative misrepresentations of the type prohibited by *Tweel*,

the court must decide whether the revenue agents were in fact conducting a criminal investigation. It has been shown that a civil audit evolves into a criminal investigation at the point when the auditors develop a firm indication of fraud. Under this rule, the court must find that the revenue agents were engaged in a covert criminal investigation if they continued to audit defendant after they developed a firm indication of fraud.

In this case, there is insufficient evidence to support the conclusion that the revenue agents had a firm indication of fraud prior to the completion of their fraud referral. *See. e.g.*, IRM § 4565.21(1); *Piper*, 681 F. Supp. at 838. First, the fact that the investigation was prompted by an information item does not, by itself, establish a firm indication of fraud. The IRS routinely channels public information items to the CID without making any preliminary evaluation of their probable merit. Because many of these tips ultimately prove to be frivolous, it would be impractical for the CID to launch full-scale criminal investigations into each of the thousands of information items that it receives each year.

Second, it is apparent that the particular information items that Mr. Peters furnished to Special Agent Padar did not constitute a firm indication of fraud. While the information was sufficiently compelling to prevent Padar from disposing of the file altogether, it certainly did not capture his immediate attention. In fact, Padar did nothing to pursue the case over the next eighteen months but drive by defendant's house exactly one time. The fact that he waited until the IRS moved its offices to carry the case file across the hall to the Examination Division suggests that the transfer may have had more to do with routine housecleaning than with a calculated attempt to use a civil audit as a front for a criminal investigation. This conclusion is further supported by the fact that the CID relinquished all connection with the case after transferring it to the Examination Division. For these reasons, the court cannot accept that the CID had a firm indica-

tion of fraud prior to the time that it transferred the Peters file to the Examination Division.

Third, the Examination Division did not act improperly by continuing its audit of Dr. Peters after Revenue Agent Thompson initiated her fraud referral in the spring of 1991. Bruce Wilson, Thompson's immediate supervisor at that time, explained that the audit continued because Thompson's work contained significant errors which rendered the initial fraud referral defective. This explanation closely resembles that which the Fifth Circuit accepted in *Powell*, 835 F.2d at 1096-1097, where the Examination Division continued an audit in the face of a faulty fraud referral prepared by an inexperienced revenue agent. The court accepts this explanation for why the audit continued after Thompson initiated her fraud referral in May of 1991.

Fourth, and finally, there is no reason to believe that Revenue Agents Lensink and Mittl developed a firm indication of fraud at any point before they initiated their fraud referral in December of 1991. The IRS would not have needed to seek consent to extend its investigation on November 4, 1991, if it already had enough evidence to refer the case to the CID. More significantly, however, the firm indications rule confers broad discretion on the Examination Division to decide exactly how much evidence is necessary to substantiate a fraud referral. Defendant has presented insufficient evidence to support her contention that the Examination Division abused this discretion by collecting more information during the fall of 1991 than it needed to substantiate a fraud referral.

The court therefore finds that, under the "firm indications rule," the revenue agents were not engaged in a covert criminal investigation of defendant. This conclusion is amply supported by existing case law. In *Caldwell*, 820 F.2d at 1400, the Fifth Circuit held that a civil audit did not constitute a criminal investigation merely because it was prompted by an information

item and referred to the Examination Division from the CID. The court decided that the information item did not constitute distinct evidence of fraud per se and thus did not require a full CID investigation. *Id.* at 1397, 1400. It therefore rejected the argument that the civil audit was nothing more than a clandestine criminal investigation by the CID. *Id.* at 1400.

Similarly, in *Piper*, 681 F. Supp. 833, the court held that a revenue agent properly characterized an audit as "routine" even though it had been prompted by a tip from an informant and referred by the CID. The CID had reviewed the information item, determined that the case lacked criminal potential, and referred it to the Examination Division for an audit. *Id.* at 838. Upon discovering firm indications of fraud, however, the Examination Division referred the case back to the CID. *Id.* The court held that the audit was not a criminal investigation prior to the fraud referral because "the decision to refer a matter from the civil division to the CID is a discretionary one." *Id.* at 838-839.

Tweel does not require a contrary result. In that case, the court held that a revenue agent may not characterize an audit as routine if the taxpayer is the subject of a concurrent criminal investigation by the IRS or some other law enforcement agency. Here, however, the Examination Division had no firm indication of fraud prior to making its fraud referral in December of 1991. Moreover, there is no evidence that the CID or any other law enforcement agency was conducting a criminal investigation in conjunction with the civil audit. Thus, the revenue agents properly characterized their investigation as a routine civil audit.

While the court is compelled to reach this conclusion on the basis of the prevailing "firm indications" rule, it nevertheless has grave reservations about relying exclusively on this rule to determine whether a criminal investigation is in progress. The court perceives that the "firm indications" rule suffers from two significant flaws. First, the Examination Division uses the term

"firm indication of fraud" merely to describe the quantum of evidence that it needs to transfer a case to the CID. Thus, Revenue Agent Margo Thompson testified that her group manager had exclusive authority to determine what evidence constitutes a firm indication of fraud. Then Bruce Wilson, a supervisor in the Examination Division, testified that "a firm indication of fraud is when I, as group manager, sign the fraud referral form." Unless the term "firm indication of fraud" is defined in relation to fixed evidentiary criteria, however, its meaning evaporates in circularity. In its current usage, the term is a classic example of bureaucratic double-talk and improperly shields the fraud referral process from judicial scrutiny.

Second, the "firm indication" rule supports a bifurcated system of tax enforcement which is based on the assumption that a civil audit is not really a criminal investigation. This assumption is simply erroneous. Although the vast majority of civil audits do not lead to criminal prosecutions, some do. To argue that the subject of a civil audit should be denied the same constitutional protections afforded to the subject of a CID investigation is analogous to arguing that the subject of a police stop should be denied constitutional protections because most such stops do not lead to criminal prosecution. If the evidence gathered in a civil audit may be used in a criminal prosecution, then the civil audit is part of a criminal investigation. The "firm indications rule" is at best a permeable and at worst an invisible barrier between the civil and criminal investigative functions of the IRS.

To the extent that the current rule hangs on a formalistic distinction between civil and criminal tax investigations, it invites the IRS to engage in "constructive dishonesty" with the taxpayer. The court finds this result highly disturbing for the reason that

> a private person has the right to expect that the government, when acting in its own name, will behave honorably. When

> a government agent presents himself to a private individual, and seeks that individual's cooperation based on his status as a government agent, the individual should be able to rely on the agent's representations. [It is] clearly improper for a government agent to gain access to records which would otherwise be unavailable to him by invoking the private individual's trust in his government, only to betray that trust.

S.E.C. v. ESM Government Securities. Inc., 645 F.2d 310, 316 (5th Cir. Unit B 1981). Under the prevailing "firm indications" rule, however, the court must conclude that Revenue Agents Thompson and Lensink did not affirmatively misrepresent their inquiry by describing it as routine civil audit.

B.

Defendant suggests that the revenue agents breached an affirmative duty to warn her that their audit might lead to criminal sanctions. It is well established that revenue agents have no duty to provide *Miranda* warnings to taxpayers in non-custodial interviews. *Beckwith*, 425 U.S. 341. Nevertheless, "revenue agents must not affirmatively mislead a taxpayer into believing that [an] investigation is exclusively civil in nature and will not lead to criminal consequences." *United States v. Lehman*, 468 F.2d 93, 105 (7th Cir. 1971); *see also Mapp*, 561 F.2d at 689, *United States v. Prudden*, 424 F.2d 1021, 1032 (5th Cir. 1970), *Cohen*, 405 F.2d at 36, and *Robson*, 477 F.2d 13, 15 (9th Cir. 1973).

Revenue agents do not, however, have an affirmative duty to disclose that an audit might result in criminal charges unless they are asked. *See Serlin*, 707 F.2d at 956 ("failure to inform defendant that ... the investigation was criminal in nature, does not amount to affirmative deceit unless defendant inquired about the nature of the investigation and the agent's failure to respond was intended to mislead"); *Powell*, 835 F.2d at 1099 ("[R]evenue

agents have no duty to inform taxpayers that the agents' investigations might result in criminal charges"); *Lehman*, 468 F.2d at 105 (no misrepresentation where revenue agents said nothing regarding criminal liability and defendant made no inquiries); *Robson*, 477 F.2d at 18 (revenue agents have "no duty to mention the possible criminal consequences of [an] audit" if they are "[n]ever queried as to the scope of [their] investigation"); *Kaatz*, 705 F.2d at 1243 ("[f]ailure to warn that a criminal investigation may ensue is not fraud, deceit, or trickery").

The Fifth Circuit held in *Prudden* that the "mere failure of a revenue agent (be he regular or special) to warn the taxpayer that the investigation may result in criminal charges, absent any acts by the agent which materially misrepresent the nature of the inquiry, do[es] not constitute ... deceit." 424 F.2d at 1033. *Accord Powell*, 835 F.2d at 1099; *Caldwell*, 820 F.2d at 1399; *Robson*, 477 F.2d at 17-18. The court reasoned that "silence can only be equated with fraud where there is a legal or moral duty to speak or where an inquiry left unanswered would be intentionally misleading." *Prudden*, 424 F.2d at 1032. Nevertheless, it concluded that auditors have no duty to explain the potential criminal results of a civil audit because "the warning at the bottom of every tax form" provides adequate notice of potential criminal liability. *Id.* at 1034.

The Second Circuit adopted a similar position in *United States v. Squeri*, 398 F.2d 785, 788 (2d Cir. 1968), where it asserted that the mere fact of an audit should be sufficient to confer notice of potential criminal liability. The court held that "[t]he information that a taxpayer's returns are under audit gives notice of the possibility of criminal prosecution regardless of whether the agents contemplate civil or criminal action when they speak to him." *Cited with approval Prudden*, 424 F.2d at 1033 n.26.

Applying this rule to criminal investigations, the First Circuit held in *Irvine* that two special agents of the CID did not

misrepresent their investigation by failing to mention that the defendant was the subject of a criminal investigation. 699 F.2d at 45. The court indicated that "[n]o case holds that an IRS agent breaches a constitutional duty when he obtains information merely by failing to state specifically that he is conducting a criminal investigation." *Id.* at 46.

As noted above, the only conceivable circumstance under which an auditor may have a duty to reveal the possibility of criminal liability is in response to a direct question from the taxpayer. There is no credible evidence in this case, however, that defendant or her agents ever asked the auditors whether the investigation might lead to criminal charges. It is therefore unnecessary for the court to decide whether the warning of potential criminal liability contained in the Privacy Act Notice was sufficient to discharge this contingent duty to warn. The court concludes, then, that the revenue agents did not have a duty to inform defendant that their audit might lead to criminal charges.

C.

Finally, defendant suggests that the IRS breached a duty to inform her that the audit was prompted by an information item. It is clear, however, that no such duty exists. *See United States v. Meier*, 607 F.2d 215, 216-217 (8th Cir. 1979) (agent's silence in response to inquiry about whether audit was prompted by informant was not misleading), *Robson*, 477 F.2d at 17 (revenue agent has no duty to disclose that the purpose of an audit is to verify information rendered by an informant), and *Cardwell*, 765 F.2d at 780 (same).

Rather, IRS regulations prevent revenue agents from revealing that an audit was prompted by an information item. The Internal Revenue Code prohibits the IRS from disclosing ' any return or return information" that "would identify a confidential

informant." 26 U.S.C. § 6103(i)(B). Similarly, the Internal Revenue Manual provides that

> [t]he source of information when furnished by informants or other confidential sources, [the] identity of any informants, and [the] methods of obtaining information will not be divulged to the taxpayer under investigation or other unauthorized persons.

IRM § 9373.1(1). When a taxpayer asks an agent directly whether a particular audit was prompted by an information item, then, the revenue agent must respond that he or she is not permitted to answer that question. These rules, together with the cases cited above, clearly establish that the IRS did not affirmatively mislead defendant by failing to explain the genesis of its investigation.

ORDERED: Defendant, Dr. Florence L. Peters' motion to suppress is denied.

Entered:
/s/ George W. Lindberg
George W. Lindberg
United States District Judge

Date: October 21, 1996

APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT
CHICAGO, ILLINOIS 60604

JUDGMENT—WITH ORAL ARGUMENT

Date: August 17, 1998

BEFORE: Honorable FRANK H. EASTERBROOK,
Circuit Judge

Honorable KENNETH F. RIPPLE, Circuit Judge

Honorable TERENCE T. EVANS, Circuit Judge

No. 97-2634

UNITED STATES OF AMERICA,
Plaintiff–Appellee

v.

FLORENCE L. PETERS,
Defendant–Appellant

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division No. 95 CR 216, George W. Lindberg, Judge

The judgment of the District Court is AFFIRMED, in accordance with the decision of this court entered on this date.

(1061-110393)

APPENDIX D

UNITED STATES CONSTITUTION

AMENDMENT IV—SEARCHES AND SEIZURES

The right of the people to be secure in their persons, houses, papers, and effects, against unreasonable searches and seizures, shall not be violated, and no Warrants shall issue, but upon probable cause, supported by Oath or affirmation, and particularly describing the place to be searched, and the persons or things to be seized.

AMENDMENT V—GRAND JURY INDICTMENT FOR CAPITAL CRIMES; DOUBLE JEOPARDY; SELF-INCRIMINATION; DUE PROCESS OF LAW; JUST COMPENSATION FOR PROPERTY

No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offence to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty or property, without due process of law; nor shall private property be taken for public use, without just compensation.

APPENDIX E

UNITED STATES CODE ANNOTATED

Title 26
Internal Revenue Code

1998

Cumulative Annual Pocket Part

Replacing 1997 pocket part in back of 1989 bound volume

Includes the Laws of the
105th CONGRESS, First Session (1997)

For close of Notes of Decisions
See page III

For Later Laws and Cases
Consult
USCA
Interim Pamphlet Service

WEST GROUP
ST. PAUL, MINN.

§ 7521. Procedures involving taxpayer interviews

(a) Recording of interviews.—

(1) Recording by taxpayer.—Any officer or employee of the Internal Revenue Service in connection with any in-person interview with any taxpayer relating to the determination or collection of any tax shall, upon advance request of such taxpayer, allow the taxpayer to make an audio recording of such interview at the taxpayer's own expense and with the taxpayer's own equipment.

(2) Recording by IRS officer or employee.—An officer or employee of the Internal Revenue Service may record any

interview described in paragraph (1) if such officer or employee—

(A) informs the taxpayer of such recording prior to the interview, and

(B) upon request of the taxpayer, provides the taxpayer with a transcript or copy of such recording but only if the taxpayer provides reimbursement for the cost of the transcription and reproduction of such transcript or copy.

(b) Safeguards.—

(1) Explanations of processes.—An officer or employee of the Internal Revenue Service shall before or at an initial interview provide to the taxpayer—

(A) in the case of an in-person interview with the taxpayer relating to the determination of any tax, an explanation of the audit process and the taxpayer's rights under such process, or

(B) in the case of an in-person interview with the taxpayer relating to the collection of any tax, an explanation of the collection process and the taxpayer's rights under such process.

(2) Right of consultation.—If the taxpayer clearly states to an officer or employee of the Internal Revenue Service at any time during any interview (other than an interview initiated by an administrative summons issued under subchapter A of chapter 78) that the taxpayer wishes to consult with an attorney, certified public accountant, enrolled agent, enrolled actuary, or any other person permitted to represent the taxpayer before the Internal Revenue Service, such officer or employee shall suspend such interview regardless of whether the taxpayer may have answered one or more questions.

(c) Representatives holding power of attorney.—Any attorney, certified public accountant, enrolled agent, enrolled actuary, or any other person permitted to represent the taxpayer before the Internal Revenue Service who is not disbarred or suspended from practice before the Internal Revenue Service and who has a written power of attorney executed by the taxpayer may be authorized by such taxpayer to represent the taxpayer in any interview described in subsection (a). An officer or employee of the Internal Revenue Service may not require a taxpayer to accompany the representative in the absence of an administrative summons issued to the taxpayer under subchapter A of chapter 78. Such an officer or employee, with the consent of the immediate supervisor of such officer or employee, may notify the taxpayer directly that such officer or employee believes such representative is responsible for unreasonable delay or hindrance of an Internal Revenue Service examination or investigation of the taxpayer.

(d) Section not to apply to certain investigations.—This section shall not apply to criminal investigations or investigations relating to the integrity of any officer or employee of the Internal Revenue Service.

(Added Pub.L. 100–647, Title VI, § 6228(a), Nov. 10, 1988, 102 Stat. 3731, § 7520, and renumbered § 7521, Pub.L. 101–239, Title VII, § 7816(u)(1), Dec. 19, 1989, 103 Stat. 2423.)

HISTORICAL AND STATUTORY NOTES

Revision Notes and Legislative Reports

1989 Act. House Report No. 101–247, House Conference Report No. 101–386, and Statement by President, see 1989 U.S. Code Cong. and Adm. News, p. 1906.

Effective Dates

1989 Act. Renumbering of section by Pub.L. 101–239 effective as if included in the provision of Pub.L. 100–647 to which

the renumbering relates, see section 7817 of Pub.L. 101–239 set out as a note under section 1 of this title.

1988 Acts. Section 6228(d) of Pub.L. 100–647 provided that: "The amendments made by subsections (a) and (c) [enacting this section] shall apply to interviews conducted on or after the date which is 90 days after the date of the enactment of this Act [Nov. 10, 1988]."

BEST AVAILABLE COPY

Your Rights AS A TAXPAYER

As a taxpayer, you have the right to be treated fairly, professionally, promptly, and courteously by Internal Revenue Service employees. Our goal at the IRS is to protect your rights so that you will have the highest confidence in the integrity, efficiency, and fairness of our tax system. To ensure that you always receive such treatment, you should know about the many rights you have at each step of the tax process.

Free Information and Help in Preparing Returns

You have the right to information and help in complying with the tax laws. In addition to the basic instructions we provide with the tax forms, we make available a great deal of other information.

Taxpayer publications. We publish over 100 free taxpayer information publications on various subjects. One of these, Publication 910, *Guide to Free Tax Services*, is a catalog of the free services and publications we offer. You can order all publications and any tax forms or instructions you need by calling us toll-free at 1-800-424-FORM (3676).

Other assistance. We provide walk-in tax help at many IRS offices and recorded telephone information on many topics through our *Tele-Tax* system. The telephone numbers for *Tele-Tax*, and the topics covered, are in certain tax forms' instructions and publications. Many of our materials are available in Braille (at regional libraries for the handicapped) and in Spanish. We provide help for the hearing impaired via special telephone equipment.

We have informational videotapes that you can borrow. In addition, you may want to attend our education programs for specific groups of taxpayers, such as farmers and those with small businesses.

In cooperation with local volunteers, we offer free help in preparing tax returns for low-income and elderly taxpayers through the Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) Programs. You can get information on these programs by calling the toll-free telephone number for your area.

Copies of tax returns. If you need a copy of your tax return for an earlier year, you can get one by filling out Form 4506, *Request for Copy of Tax Form*, and paying a small fee. However, you often only need certain information, such as the amount of your reported income, the number of your exemptions, and the tax shown on the return. You can get this information free if you write or visit an IRS office or call the toll-free number for your area.

If you have trouble clearing up any tax matter with the IRS through normal channels, you can get special help from our Problem Resolution Office, as explained later.

Privacy and Confidentiality

You have the right to have your personal and financial information kept confidential. People who prepare your return or represent you *must* keep your information confidential.

You also have the right to know why we are asking you for information, exactly how we will use any information you give, and what might happen if you do not give the information.

Information sharing. Under the law, we can share your tax information with State tax agencies and, under strict legal guidelines, the Department of Justice and other federal agencies. We can also share it with certain foreign governments under tax treaty provisions.

Courtesy and Consideration

You are always entitled to courteous and considerate treatment from IRS employees. If you ever feel that you are not being treated with fairness, courtesy, and consideration by an IRS employee, you should tell the employee's supervisor.

Representation and Recordings

Throughout your dealings with us, you can represent yourself, or, generally with proper written authorization, have someone represent you in your absence. During an interview, you can have someone accompany you.

If you want to consult an attorney, a certified public accountant, an enrolled agent, or any other person permitted to represent a taxpayer during an interview for examining a tax return or collecting tax, we will stop and reschedule the interview. We cannot suspend the interview if you are there because of an administrative summons.

You can generally make an audio recording of an interview with an IRS Collection or Examination officer. You must notify us 10 days before the meeting and bring your own recording equipment. We also can record an interview. If we do so, we will notify

Department of the Treasury
Internal Revenue Service
Publication 1 (Rev. 6-89)

Attorney Ex. 75A
9/12/96
ONC

you 10 days before the meeting and you can get a copy of the recording at your expense.

Payment of Only the Required Tax

You have the right to plan your business and personal finances so that you will pay the least tax that is due under the law. You are liable only for the correct amount of tax. Our purpose is to apply the law consistently and fairly to all taxpayers.

If Your Return is Questioned

We accept most taxpayers' returns as filed. If we inquire about your return or select it for examination, it does not suggest that you are dishonest. The inquiry or examination may or may not result in more tax. We may close your case without change. Or, you may receive a refund.

Examination and inquiries by mail. We handle many examinations and inquiries entirely by mail. We will send you a letter with either a request for more information or a reason why we believe a change needs to be made to your return. If you give us the requested information or provide an explanation, we may or may not agree with you and we will explain the reasons for any changes. You should not hesitate to write to us about anything you do not understand. If you cannot resolve any questions through the mail, you can request a personal interview. You can appeal through the IRS and the courts. You will find instructions with each inquiry or in Publication 1383, *Correspondence Process*.

Examination by interview. If we notify you that we will conduct your examination through a personal interview, or you request such an interview, you have the right to ask that the examination take place at a reasonable time and place that is convenient for both you and the IRS. If the time or place we suggest is not convenient, the examiner will try to work out something more suitable. However, the IRS makes the final determination of how, when, and where the examination will take place. You will receive an explanation of your rights and of the examination process either before or at the interview.

If you do not agree with the examiner's report, you may meet with the examiner's supervisor to discuss your case further.

Repeat examinations. We try to avoid repeat examinations of the same items, but this sometimes happens. If we examined your tax return for the same items in either of the 2 previous years and proposed no change to your tax liability, please contact us as soon as possible so we can see if we should discontinue the repeat examination.

Explanation of changes. If we propose any changes to your return, we will explain the reasons for the changes. It is important that you understand these reasons. You should not hesitate to ask about anything that is unclear to you.

Interest. You must pay interest on additional tax that you owe. The interest is figured from the due date of the return. But if our error caused a delay in your case, and this was grossly unfair, we may reduce the interest. Only delays caused by procedural or mechanical acts not involving the exercise of judgment or discretion qualify. If you think we caused such a delay, please discuss it with the examiner and file a claim for refund.

Business taxpayers. If you are in an individual business, the rights covered in this publication generally apply to you. If you are a member of a partnership or a shareholder in a small business corporation, special rules may apply to the examination of your partnership or corporation items. The examination of partnership items is discussed in Publication 556, *Examination of Returns, Appeal Rights, and Claims for Refund*. The rights covered in this publication generally apply to exempt organizations and sponsors of employee plans.

An Appeal of the Examination Findings

If you don't agree with the examiner's findings, you have the right to appeal them. During the examination process, you will be given information about your appeal rights. Publication 5, *Appeal Rights and Preparation of Protests for Unagreed Cases*, explains your appeal rights in detail and tells you exactly what to do if you want to appeal.

Appeals Office. You can appeal the findings of an examination within the IRS through our Appeals Office. Most differences can be settled through this appeals system without expensive and time-consuming court trials. If the matter cannot be settled to your satisfaction in Appeals, you can take your case to court.

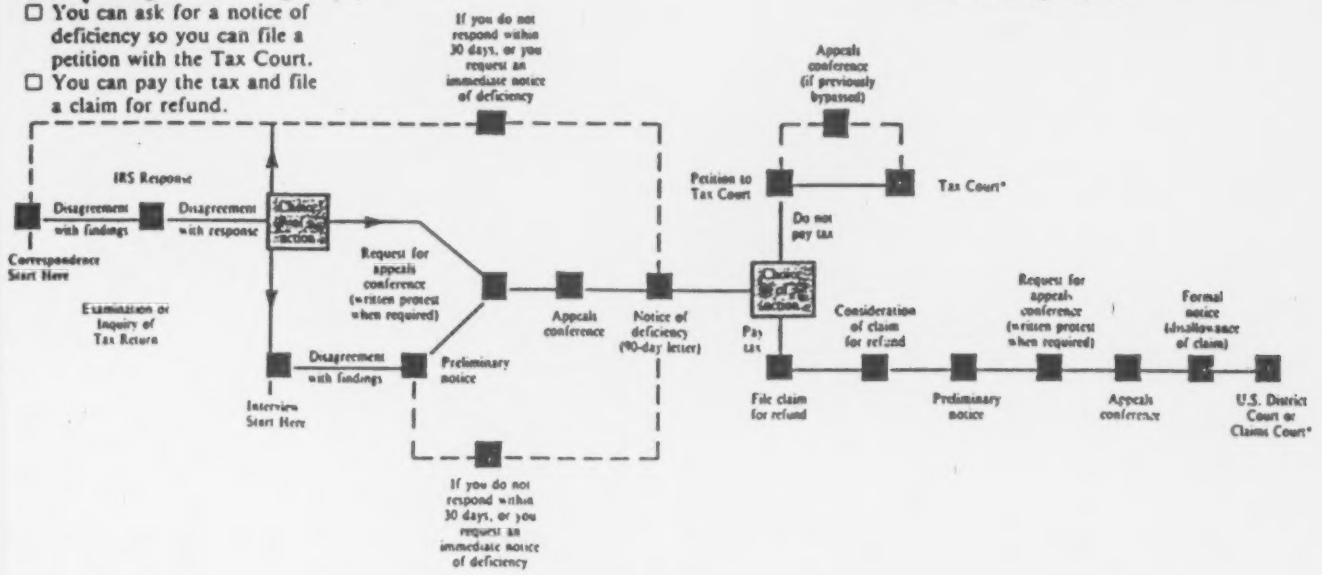
Appeals to the courts. Depending on whether you first pay the disputed tax, you can take your case to the U.S. Tax Court, the U.S. Claims Court, or your U.S. District Court. These courts are entirely independent of the IRS. As always, you can represent yourself or have someone admitted to practice before the court represent you.

If you disagree about whether you owe additional tax, you generally have the right to take your case to

Income Tax Appeal Procedure

At any stage
- ☐ You can agree and arrange to pay.
- ☐ You can ask for a notice of deficiency so you can file a petition with the Tax Court.
- ☐ You can pay the tax and file a claim for refund.

*Further appeals to the courts may be possible, except there is no appeal under the Tax Court's small tax case procedure.



the U.S. Tax Court if you have not yet paid the tax. Ordinarily, you have 90 days from the time we mail you a formal notice (called a "notice of deficiency") telling you that you owe additional tax, to file a petition with the U.S. Tax Court. You can request simplified small tax case procedures if your case is $10,000 or less for any period or year. A case settled under these procedures cannot be appealed.

If you have already paid the disputed tax in full, you may file a claim for refund. If we disallow the claim or do not take action within 6 months, then you may take your case to the U.S. Claims Court or your U.S. District Court.

Recovering litigation expenses. If the court agrees with you on most issues in your case, and finds that our position was largely unjustified, you may be able to recover some of your administrative and litigation costs. To do this, you must have used all the administrative remedies available to you within the IRS. This includes going through our Appeals system and giving us all the information necessary to resolve the case.

Publication 556, *Examination of Returns, Appeal Rights, and Claims for Refund*, will help you more fully understand your appeal rights.

Fair Collection of Tax

Whenever you owe tax, we will send you a bill describing the tax and stating the amounts you owe in tax, interest, and penalties. Be sure to check any bill you receive to make sure it is correct. You have the right to have your bill adjusted if it is incorrect, so you should let us know about an incorrect bill right away.

If we tell you that you owe tax because of a math or clerical error on your return, you have the right to ask us to send you a formal notice (a "notice of deficiency") so that you can dispute the tax, as discussed earlier. You do not have to pay the additional tax at the same time that you ask us for the formal notice, if you ask for it within 60 days of the time we tell you of the error.

If the tax is correct, we will give you a specific period of time to pay the bill in full. If you pay the bill within the time allowed, we will not have to take any further action.

We may request that you attend an interview for the collection of tax. You will receive an explanation of your rights and of the collection process either before or at the interview.

Your rights are further protected because we are not allowed to use tax enforcement results to evaluate our employees.

Payment arrangements. You should make every effort to pay your bill in full. If you can't, you should pay as much as you can and contact us right away. We may ask you for a complete financial statement to determine how you can pay the amount due. Based on your financial condition, you may qualify for an installment agreement. We will give you copies of all agreements you make with us.

If we approve a payment agreement, the agreement will stay in effect only if:

- You give correct and complete financial information,
- You pay each installment on time,
- You satisfy other tax liabilities on time,
- You provide current financial information when asked, and
- We determine that collecting the tax is not at risk.

Following a review of your current finances, we may change your payment agreement. We will notify you 30 days before any change to your payment agreement and tell you why we are making the change.

We will not take any enforcement action (such as recording a tax lien, or levying on or seizing property), until after we have tried to contact you and given you the chance to voluntarily pay any tax due. Therefore, it is very important for you to respond right away to our attempts to contact you (by mail, telephone, or personal visit). If you do not respond, we may have no choice but to begin enforcement.

Release of liens. If we have to place a lien on your property (to secure the amount of tax due), we must release the lien no later than 30 days after finding that you have paid the entire tax and certain charges, the assessment has become legally unenforceable, or we have accepted a bond to cover the tax and certain charges.

Recovery of damages. If we knowingly or negligently fail to release a lien under the circumstances described above, and you suffer economic damages because of our failure, you can recover your actual economic damages and certain costs.

If we recklessly or intentionally fail to follow the laws and regulations for the collection of tax, you can recover actual economic damage and costs.

In each of the two situations above, damages and costs will be allowed within the following limits. You must exhaust all administrative remedies available to you. The damages will be reduced by the amount which you could have reasonably prevented. You must bring suit within 2 years of the action.

Incorrect lien. You have the right to appeal our filing of a Notice of Federal Tax Lien if you believe we filed the lien in error. If we agree, we will issue a certificate of release, including a statement that we filed the lien in error.

A lien is incorrect if:

- You paid the entire amount due before we filed the lien,
- We made a procedural error in a deficiency assessment, or
- We assessed a tax in violation of the automatic stay provisions in a bankruptcy case.

Levy. We will generally give you 30 days notice before we levy on any property. The levy may be given to you in person, mailed to you, or left at your home or workplace. We cannot place a levy on your property on a day on which you are required to attend a collection interview.

Property that is exempt from levy. If we must seize your property, you have the legal right to keep:

- Necessary clothing and schoolbooks,
- A limited amount of personal belongings, furniture, and business or professional books and tools,
- Unemployment and job training benefits, workers' compensation, welfare, certain disability payments, and certain pension benefits,
- The income you need to pay court-ordered child support,
- Mail,
- An amount of weekly income equal to your standard deduction and allowable personal exemptions, divided by 52, and
- Your main home, except in certain situations.

If your bank account is levied after June 30, 1989, the bank will hold your account up to the amount of the levy for 21 days. This allows you to resolve your tax bill before the bank turns over the funds to the IRS.

We generally must release a levy issued after June 30, 1989, if:

- You pay the tax, penalty, and interest for which the levy was made,
- The IRS determines the release will help collect the tax,
- You have an approved installment agreement for the tax on the levy,
- The IRS determines the levy is creating an economic hardship, or

The fair market value of the property exceeds the amount of the levy and release would not hinder the collection of tax.

If at any time during the collection process you do not agree with the collection officer, you can discuss your case with his or her supervisor.

If we seize your property, you have the right to request that it be sold within 60 days after your request. You can request a time period greater than 60 days. We will comply with your request unless it is not in the best interest of the government.

Access to your private premises. A court order is not generally needed for a collection officer to seize your property. However, you don't have to allow the employee access to your private premises, such as your home or the non-public areas of your business, if the employee does not have court authorization to be there.

Withheld taxes. If we believe that you were responsible for seeing that a corporation paid us income and social security taxes withheld from its employees, and the taxes were not paid, we may look to you to pay an amount based on the unpaid taxes. If you feel that you don't owe this, you have the right to discuss the case with the collection officer's supervisor. Also, you generally have the same IRS appeal rights as other taxpayers. Because the U.S. Tax Court has no jurisdiction in this situation, you must pay at least part of the withheld taxes and file a claim for refund in order to take the matter to the U.S. District Court or U.S. Claims Court.

The Collection Process

To stop the process at any stage, you should pay the tax in full. If you cannot pay the tax in full, contact us right away to discuss possible ways to pay the tax.

Start here

- First notice and demand for unpaid tax
- 10 days later
- Enforcement authority arises
- Up to 3 more notices sent over a period of time asking for payment
- Notice of intent to levy is sent by certified mail (final notice)
- 30 days later
- Enforcement action to collect the tax begins (lien, levy, seizure, etc.)

Publications 556A, *The Collection Process (Income Tax Accounts)*, and 594, *The Collection Process (Employment Tax Accounts)*, will help you understand your rights during the collection process.

Refund of Overpaid Tax

Once you have paid all your tax, you have the right to file a claim for a refund if you think the tax is incorrect. Generally, you have 3 years from the date you filed the return or 2 years from the date you paid the tax (whichever is later) to file a claim. If we examine your claim for any reason, you have the same rights that you would have during an examination of your return.

Interest on refunds. You will receive interest on any income tax refund delayed more than 45 days after the later of either the date you filed your return or the date your return was due.

Checking on your refund. Normally, you will receive your refund about 6 weeks after you file your return. If you have not received your refund within 8 weeks after mailing your return, you may check on it by calling the toll-free *Tele-Tax* number in the tax forms' instructions.

If we reduce your refund because you owe a debt to another Federal agency or because you owe child support, we must notify you of this action. However, if you have a question about the debt that caused the reduction, you should contact the other agency.

Cancellation of Penalties

You have the right to ask that certain penalties (but not interest) be cancelled (abated) if you can show reasonable cause for the failure that led to the penalty (or can show that you exercised due diligence, if that is the applicable standard for that penalty).

If you relied on wrong advice you received from IRS employees on the toll-free telephone system, we will cancel certain penalties that may result. But you have to show that your reliance on the advice was reasonable.

If you relied on incorrect written advice from the IRS in response to a written request you made after January 1, 1989, we will cancel any penalties that may result. You must show that you gave sufficient and correct information and filed your return after you received the advice.

Special Help to Resolve Your Problems

We have a Problem Resolution Program for taxpayers who have been unable to resolve their problems with the IRS. If you have a tax problem that you cannot clear up through normal channels, write to the Problem Resolution Office in the district or Service Center with which you have the problem. You may also reach the Problem Resolution Office by calling the IRS taxpayer assistance number for your area.

If you suffer or are about to suffer a significant hardship because of the administration of the tax laws, you may request assistance on Form 911, *Application For Assistance Order to Relieve Hardship*. The Taxpayer Ombudsman or a Problem Resolution Officer will review your application and may issue a Taxpayer Assistance Order (TAO). You can get copies of Form 911 in IRS offices or by calling toll-free 1-800-424-FORM (3676).

Protection of Your Rights

The employees of the Internal Revenue Service will explain and protect your rights as a taxpayer at all times. If you feel that this is not the case, you should discuss the problem with the employee's supervisor. Your local Problem Resolution Officer will assist you if you are unable to resolve the problem with the supervisor.

Taxpayer Assistance Numbers

You should use the telephone number shown in the white pages of your local telephone directory under U.S. Government, Internal Revenue Service, Federal Tax Assistance. If there is not a specific number listed, call toll-free 1-800-424-1040. You can also find these phone numbers in the instructions for Form 1040.

You may also use these numbers to reach the Problem Resolution Office. Ask for the Problem Resolution Office when you call.

U.S. taxpayers abroad may write for information to:

Internal Revenue Service
Attn: IN:C:TPS
950 L'Enfant Plaza South, S.W.
Washington, D.C. 20024

You can also contact your nearest U.S. Embassy for information about what services and forms are available in your location.

GOVERNMENT EXHIBIT THOMPSON 1A

TAXPAYER

IN RE: FLORENCE PETERS
340-44-7199

Florence Peters is a Podiatrist.
She deducts virtually all of her personal expenses as business expenses according to the informant.
She rents office space from another doctor who leases that space himself. Peters rents this space from him on days that that doctor is not there.
She does surgery at North West Community Hospital - Arlington Heights and maybe Lutheran General Hospital in Park Ridge.

Examples of false expenses are:

GOLD LEAF LIMOUSINE SERVICE for transporting her children to school (private school in Northbrook. It's called Solomen Schecter telephone (708) 498-2100. Spends 8,000 to 10,000/yr for private school.

She doesn't directly lease her office space but deducts plumbers expenses.

She has 1978 Mercedes Benz 230. It's fully depreciated.

Has 1984 Datsun ZX.

She expenses a car that her live-in boyfriend uses.

She deducts checks to Dominick's grocery as office expense.

Her home phone number 394-4155 as labeled on check #1949 as business is personal.

Check #1960 - "office electric bill" She doesn't pay for office electricity.

Check #2525 dated 7/25/88 for $2006.29 was for hot tub put into her house addition. She's taking it as office expense.

She has no personal checking act. All checks that she writes are on her business account and deducted as business expenses.

She was born 11/25/50
Graduated U of Illinois C.C. 1972
Ill College of Podiatric Medicine 1976.

Married 1971 in Cook County.
Divorced from Marshall Peters 1983 in Cook County
Her Maiden surname is Katz.

Informant provided extensive list of bogus expenses.

3/7/89

3/7/80

Dear Mr. Padar,

Enclosed is the invitation sent to Marshall for the Bat Mitzv. Florence Peters told him the affa is costing her $100,000. at $200.00 apla I'm sure whatever the cost it will be deducted from 1990 tax return. I'm also sure the down payment for Bat Mitzvah and cost of printing these invites will be deducted in 1989 tax return (office party, business printing expense.)

Sincerely
Ellie Peters